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No. 94-56

IN THE
SUPREME COURT of the UNITED STATES
OCTOBER TERM, 1994

RICHARD MITCHELL AND LARRY COTTEN,
Petitioners,

v.

STATE FARM FIRE AND CASUALTY COMPANY,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the United States Court of Appeals for the Tenth Circuit acted contrary to the Seventh Amendment to the United States Constitution by failing to reconcile allegedly inconsistent jury verdicts and failing to uphold the reconciliation of the verdicts by the United States District Court for the District of Colorado.

2. Whether the United States Court of Appeals for the Tenth Circuit erred in permitting the Respondent, who did not object to allegedly inconsistent jury verdicts until one month after the jury was discharged, to challenge the verdicts on appeal.

STATEMENT REGARDING PARTIES TO THE PROCEEDING

The names of all parties to the proceeding in the court whose judgment is sought to be reviewed appear in the caption of this Petition. Pursuant to Supreme Court Rule 29.1, Petitioners Richard Mitchell and Larry Cotten state that they are individuals and that such Rule therefore does not apply to them.

STATEMENT REGARDING THE UNITED STATES AND STATE OF COLORADO

Pursuant to Supreme Court Rules 29.4(b) and (c), Petitioners state that neither 28 U.S.C. § 2403(a) (1976) nor 28 U.S.C. § 2403(b) (1976) applies to this Petition.

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OPINIONS BELOW

The opinion by the United States Court of Appeals for the Tenth Circuit which forms the basis for this Petition for a Writ of Certiorari is reported as *Mitchell v. State Farm Fire and Casualty Company*, 20 F.3d 395 (10th Cir. 1994), and is reproduced in the Appendices to this Petition as Petitioners' Appendix ("Pet. App.") A at 1a. The opinion by the United States Court of Appeals for the Tenth Circuit on rehearing is reported as *Mitchell v. State Farm Fire and Casualty Company*, 15 F.3d 959 (10th Cir. 1994), and is reproduced at Pet. App. B.

The Tenth Circuit's opinions vacated a judgment entered in favor of Petitioners following trial to a jury in the United States District Court for the District of Colorado. The jury's verdicts and judgment of the District Court entered thereon are reproduced at Pet. App. C and Pet. App. D, respectively. The District Court issued an unreported oral ruling from the bench regarding the consistency of the jury's verdicts, a transcription of which ruling is reproduced at Pet. App. E.

Prior to the trial of this case, the Tenth Circuit issued an opinion on choice of law principles reported as *Mitchell v. State Farm Fire & Casualty Co.*, 902 F.2d 790 (10th Cir. 1990). That decision is reproduced at Pet. App. F. The ruling of the District Court which precipitated such prior Tenth Circuit decision, and the certification of the ruling pursuant to 28 U.S.C. § 1292(b) (1992), are reproduced at Pet. App. G and H.

JURISDICTION

The Tenth Circuit issued its opinion vacating the District Court judgment on February 1, 1994, and denied Petitioners'

Petition for Rehearing and Suggestion for Rehearing In Banc by opinion and order entered April 12, 1994. Petitioners invoke the jurisdiction of this Court pursuant to 28 U.S.C. § 1254(1) (1988).

CONSTITUTIONAL PROVISION INVOLVED

The constitutional provision involved in this case is the Seventh Amendment to the United States Constitution, which states as follows:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

STATEMENT OF THE CASE

The central issue in this Petition is whether the Tenth Circuit denied Petitioners their Seventh Amendment right to trial by jury in determining that the jury's verdicts on Petitioners' breach of contract claim and tort claim were inconsistent. A comprehensive review of the record reveals that the verdicts were not inconsistent and should have been reconciled.

A. Proceedings Prior to Trial

Over nine years ago, on May 27, 1985, a fire destroyed Petitioners' condominium located in Mt. Crested Butte, Colorado. Respondent had issued an insurance policy for fire and extended coverage of the condominium. A dispute arose between the parties regarding coverage available to Petitioners under the policy.

On July 10, 1986, Petitioners, who were residents of Arkansas, brought suit against Respondent in the United

States District Court for the Western District of Arkansas.[1] Jurisdiction for the suit was based on diversity of citizenship, *see* 28 U.S.C. § 1332(a)(1) (1976). Petitioners asserted several claims including breach of contract and breach of duty of good faith and fair dealing. The case was subsequently transferred to the United States District Court for the District of Colorado.[2]

B. Trial Proceedings

On remand, on April 20-30, 1992, trial to a jury was held on Petitioners' claims for breach of insurance contract and breach of duty of good faith and fair dealing. Petitioners based their latter claim on Respondent's conduct in two respects: (1) inducing and permitting Petitioners to overinsure the property with the belief that in the event of total loss, their mortgagees would be paid in full from policy limits, while Respondent knew that by virtue of a low appraisal which it had obtained, no such benefits would be paid; and (2) conducting an excessively long claims handling

---

[1] Petitioners' senior mortgagee lender for the condominium, First National Bank of Fort Smith, Arkansas ("the Bank"), was initially a plaintiff to Petitioners' action. The dispute as between the Bank and Respondent was subsequently resolved through arbitration, to which Petitioners were not parties. The Bank was not a party to the proceedings in the Tenth Circuit which form the basis for this Petition for a Writ of Certiorari.

[2] Both parties moved for partial summary judgment with respect to choice of law principles governing the breach of contract claim. The District Court ruled that Arkansas law applied to the claim, and certified the ruling as appealable pursuant to 28 U.S.C. § 1292(b). (Pet. App. G. and H.) Respondent appealed the ruling to the United States Court of Appeals for the Tenth Circuit. The Tenth Circuit reversed, holding that Colorado law applied. *Mitchell v. State Farm Fire & Casualty Co.*, 902 F.2d 790 (10th Cir. 1990). (Pet. App. F.)

process with the intent to coerce Petitioners into abandoning their insurance claim or settling it for below its fair value.

Petitioners communicated their two-pronged theory on their claim through direct examination, cross-examination, and closing argument of counsel. (Pet. App. I.) On the "overinsurance" aspect, Petitioner Richard Mitchell testified to his conversations with Respondent's agent concerning increasing the amount of insurance coverage on the condominium. (Pet. App. I at 2i - 6i.) Petitioners' expert witness testified that Respondent had acted improperly as it "sold too much," *i.e.*:

> [W]hen the insurance company knows that they're valuing at 158,000 and, therefore, even in the event of a total loss, would not pay more than 158,000, it's improper to sell 450,000 and collect a premium on 450,000. Relatively simple to inform the insured, [y]ou're buying too much coverage. You're wasting your premium dollar.

(Pet. App. I at 7i - 8i.) Petitioners' counsel cross-examined Respondent's expert witness as follows:

> Q: Finally, Mr. Miller, *and most importantly*, if the insurance company has actual knowledge that the policy limits on a property it insures are much higher than the property is worth, isn't it true that the company has an obligation to tell the insured that it won't insure the property at the higher policy limits?
>
> A: You're speaking in general, not specifically this case?
>
> Q: Yes.
>
> A: In general, if the insurance company -- the insurance company knows the insured is

attempting to overinsure the property, the company has an obligation not to participate in that.

Q: It has a duty to tell them?

A: Yes. Assuming (a) the company knows there's an attempt to overinsure it, yes.

Q: And what the insurance company has a duty to do in that situation is to tell the insured something like this, quote, [w]e won't take your premium because we'll never pay that much. You are wasting your money to pay that kind of premium. And more important, we don't want you to think that if there's a fire, we're going to pay anything like that? An insurance company has a duty to tell their insureds that; isn't that true?

A: Yes, if they know there's an attempt to overinsure the property.

(Pet. App. I at 8i - 9i (emphasis added).) Finally, in closing argument, Petitioners' counsel stated as follows:

> [E]ven though the insurance company knew they had this little of a replacement cost estimate, they were letting the insureds increase their coverage all the way to $450,000, creating that false sense of security, even though State Farm knew that under its policy, it would never pay, according to the written word in the policy -- it would never pay more than the -- lesser of replacement value or actual cash value.
>
> So here this agent knew -- he knew on November 4, 1983 -- that the replacement cost was 158,000. When they called up and asked him for more insurance, he said, [s]ure, here, even though he knew

> what they were wanting it for. He went ahead, sold them that insurance, created that false sense of security. Now, why would an insurance company do that? More premiums. Why would the agent do it? More commissions.

(Pet. App. I at 11i - 12i.)

With regard to Petitioners' breach of contract claim, the District Court instructed the jury as follows on the elements of the claim:

> In order for the plaintiffs Richard Mitchell and Larry Cotten to recover from the defendant State Farm Fire and Casualty Company on their claim for breach of the insurance contract, you must find that both of the following have been proved:
>
> 1. The defendant entered into a contract of insurance with the plaintiffs to insure their property in Mt. Crested Butte, Colorado; and
>
> 2. The defendant was obligated to pay the plaintiffs the amounts due pursuant to the terms of the contract.

(Pet. App. J at 1j.) The jury received the following instruction on the elements of the claim of breach of duty of good faith and fair dealing:

> In order for the plaintiffs to recover from the defendant on their claim for breach of duty of good faith and fair dealing, you must find all of the following have been proved:
>
> 1. The plaintiffs incurred damages;
>
> 2. The defendant acted unreasonably in delaying payment on plaintiffs' claim without a legitimate basis for said delay;

> 3. The defendant knew its conduct was unreasonable or the defendant recklessly disregarded the fact that its conduct was unreasonable; and
>
> 4. The defendant's unreasonable conduct was a cause of the plaintiffs' damages.

(Pet. App. J at 3j.)

The jury received the following two instructions with regard to the damages the jurors should award if they found in favor of Petitioners:

> If you find in favor of the plaintiffs on their claim of *breach of insurance contract*, then you must award them actual or nominal damages. To award actual damages, you must find by a preponderance of the evidence that the plaintiffs incurred actual damages as a result of the breach, and the amount thereof.
>
> To the extent actual damages have been proved by the evidence, you *shall award as actual damages the difference between the amount you determine should have been paid under the policy of insurance and the amount the defendant has paid*, not to exceed in the aggregate the amounts of liability under the insurance contract.

(Pet. App. J at 2j (emphases added).)

> If you find in favor of the plaintiffs Richard Mitchell and Larry Cotten on their claim of *breach of duty of good faith and fair dealing*, you shall award as their actual damages, insofar as they have been proved by a preponderance of the evidence and insofar as they were caused by the defendant's breach of its duty of good faith and fair dealing, an amount which will reasonably compensate the plaintiffs for their damages, if any.

> In determining such damages, *you shall consider any economic losses incurred to the present time, including the difference between the amount you determine should have been paid under the policy of insurance and the amount the defendant has paid*, not to exceed in the aggregate the amounts of liability under the insurance contract.

(Pet. App. J at 4j (emphases added).)

Counsel for Petitioners, in closing argument, expanded upon the damages element of the above instructions as follows:

> *On the breach of the duty of good faith and fair dealing*, again, we're not looking to get more than they are entitled to, so we're going to start with the same cap of $450,000 and, again, giving them credit for 194,000, *leaving a balance of 256,000.*

(Pet. App. I at 14i (emphases added).)

As described above, Petitioners' theory of the case on their tort claim for breach of duty of good faith and fair dealing contained two alternative components. In the event that the jury found that Respondent had breached the duty in the overinsuring context (the first theory described above), one measure of damages would have been $256,000, identical to the amount sought by Petitioners as damages for breach of contract. Thus, while the jurors were instructed on two distinct claims for relief, the measure of damages which they were to employ in either case was the same: the difference between the amount which Respondent should have paid under the insurance policy and the amount which Respondent actually paid, or the sum of $256,000 (exclusive of punitive damages, attorneys' fees, and costs).

The jury returned a general verdict against Petitioners on the breach of contract claim and a general verdict in favor of Petitioners on the claim of breach of duty of good faith and fair dealing. (Pet. App. C.) Respondent made no objections to the verdicts based on alleged inconsistency, or any other ground, before dismissal of the jury, and the jury was discharged. The district court entered judgment in the amount of $256,000 and awarded additional amounts to Petitioners for punitive damages, attorneys' fees, and costs. (Pet. App. D.)

C. Post-Trial Proceedings in the District Court

Approximately one month after the trial, at a hearing on post-trial motions, counsel for Respondent raised for the first time the issue of the alleged inconsistency of the jury verdicts. At an extensive hearing and argument on the post-trial motions, the District Court reconciled the verdicts as follows:

> THE COURT: I guess you're saying, Well, if eventually the insurance company technically complies with the letter of the policy, you can't have a bad faith claim. I don't agree with that. I guess we disagree because I think you can have a bad faith claim even in the absence of --
>
> [COUNSEL FOR RESPONDENT]: Your Honor --
>
> THE COURT: -- the letter of the policy. And therefore, *I don't see the inconsistency between the fact that they found no technical breach of the insurance contract but still*

> *found bad faith in the way it was handled.*

(Pet. App. E at 1e - 2e (emphasis added).) The court further opined as follows:

> [T]he court rejects the argument that the verdict in this case is inconsistent on the matter of the fact that since the jury -- the allegation that the jury found that State Farm did not breach the contract and, therefore, State Farm could not owe the plaintiffs any damages for economic losses incurred as a result of the bad faith failure to exercise good faith.
>
> . . . .
>
> *I think reasonable jurors could determine, as these jurors did, that the evidence did indicate that State Farm's conduct was unreasonable*; that the evidence did indicate that the insurer acted in such a manner as to indicate a knowledge and reckless disregard of the fact that the valid claim had been submitted, in the conduct of the insurer in handling the claim; and that the jurors, in fact, did determine that there was bad faith in delaying the processing of the claim and that the conduct of State Farm was unreasonable under the circumstances and that the insurer knew the conduct to be unreasonable or recklessly disregarded the fact that the conduct was unreasonable and *notwithstanding the fact that the claim was technically never denied and the jury found that State Farm did not technically violate its insurance contract, they eventually paid the claim.*
>
> *The Court still feels that the jury verdicts are not inconsistent.*

(Pet. App. E at 2e - 3e (emphases added).)

D. Post-Trial Proceedings in the Tenth Circuit

Respondent appealed to the Tenth Circuit Court of Appeals. A panel of the Tenth Circuit vacated the judgment and remanded Petitioners' claim of breach of duty of good faith and fair dealing for further proceedings. (Pet. App. A.)

The Tenth Circuit recognized that "a judgment in favor of the insurer on a breach of contract claim does not necessarily foreclose recovery by an insured for damages caused by an insurer's bad faith delay of payments due under the policy." (Pet. App. A at 8a.) Nonetheless, the court determined that the jury's verdicts were inconsistent, holding as follows:

> The inconsistency we perceive in the instant case is that the jury found for State Farm on plaintiffs' claim for breach of contract, and then awarded plaintiffs $256,000 on their breach of duty claim. As both parties indicate, this can only be explained on the basis that in awarding plaintiffs $256,000 on their breach of duty claim the jury approximated the difference between the policy limit, $450,000, and the amounts paid by State Farm to [Petitioners' mortgagees]. However, by its verdict on plaintiffs' breach of contract claim, the jury at the same time found that State Farm had fulfilled its contractual obligation under the policy by its payments to [Petitioners' mortgagees], and not only did *not* owe plaintiffs $450,000, but did not owe plaintiffs any amount. In other words, the jury by its verdict on plaintiffs' breach of contract claim found that State Farm did *not* owe plaintiffs $450,000, or any lesser sum, having discharged its contractual duty under the policy by its payments to [Petitioners' mortgagees], and then, in the next breath, so to speak, found, in

> effect, that the measure of damage for plaintiffs' breach of duty claim approximated the difference between $450,000 and the amount paid by State Farm to [Petitioners' mortgagees]. We cannot 'fairly harmonize' the two.

(Pet. App. A at 8a - 9a (emphases in original).)

Petitioners submitted a Petition for Rehearing and Suggestion for Rehearing In Banc to the Tenth Circuit. (Pet. App. K.) A panel of the Tenth Circuit denied the Petition. (Pet. App. B.) With respect to Petitioners' contention that the jury verdicts were consistent with one of Petitioners' theories of recovery on their tort-based claim, the court noted:

> It is true that in their amended complaint plaintiffs did make a possible reference to overinsurance in their claim based on an alleged breach of the duty of State Farm to exercise good faith and fair dealing with the plaintiffs. It is also correct that in closing argument to the jury, counsel for the plaintiffs stated that *both* of the plaintiffs' claims, i.e., breach of contract and breach of duty, were based, in part, on "overinsurance" and "misleading conduct." In this regard, counsel did ask the jury to return verdicts in favor of the plaintiffs on both of their claims, i.e. breach of contract and breach of duty, and to fix their damages at $256,000 on each claim, assuring the jury, at the same time, that there would be only 'one recovery.'

(Pet. App. B at 2b (emphasis in original).) The court added, however, that "the jury was nonetheless instructed, without objection, that the plaintiffs' claim based on breach of duty of good faith and fair dealing was based on unreasonable delay by State Farm in making payments due under the policy,"

and not on "overinsurance" or "misleading conduct." (Pet. App. B at 2b, 3b.) Thus, according to the court:

> We do not regard 'delayed payment' to be a synonym for 'overinsurance' or 'misleading conduct.' All of which would suggest that the jury was confused and returned verdicts which cannot be 'fairly harmonized.'

(Pet. App. B at 3b.)

In their Petition for Rehearing, Petitioners also contended that Respondent waived its right to contest the consistency of the jury verdicts by failing to raise the issue prior to the jury's discharge. (Pet. App. K.) However, the Tenth Circuit did not address this contention in its opinion on rehearing. (Pet. App. B.)

This Petition for a Writ of Certiorari followed.

REASONS FOR GRANTING THE WRIT

The Tenth Circuit has deprived Petitioners of their right to trial by jury as guaranteed by the Seventh Amendment. The Tenth's Circuit decision on this federal question conflicts with applicable decisions of this Court. The court held that jury verdicts against Petitioners on a breach of contract claim and in favor of Petitioners on a claim of breach of duty of good faith and fair dealing were inconsistent, thereby necessitating remand for a new trial. However, upon examination of relevant testimony, jury instructions, closing argument of Petitioners' counsel, and case law, it is apparent that the verdicts are not inconsistent and indeed follow Petitioners' theory of the case on their tort-based claim. The Seventh Amendment thus mandates that the jury's verdicts be reconciled in order to preserve Petitioners' right to trial by jury.

Furthermore, the Tenth Circuit has so far departed from the accepted and usual course of judicial proceedings as to

call for an exercise of this Court's power of supervision. The court improperly permitted the Respondent to challenge the consistency of the verdicts on appeal, even though Respondent did not object to the verdicts until one month after the jury was discharged. Such permission contravenes the waiver rule, under which parties must raise objections to apparently inconsistent jury verdicts to the trial court before discharge of the jury, so that the objections may be promptly resolved in the interest of judicial economy.

Therefore, this Court should grant certiorari to rectify the errors of the Tenth Circuit. *See* Supreme Court Rule 10.1(a) and (c). Alternatively, the Court should grant summary reversal of the Tenth Circuit's decision. *See* Supreme Court Rule 16.1.

A. The Tenth Circuit Acted Contrary to the Seventh Amendment by Failing to Reconcile the Jury's Verdicts and Failing to Uphold the District Court's Reconciliation of the Verdicts.

The Tenth Circuit did not make the effort required by the Seventh Amendment to reconcile seemingly inconsistent jury verdicts which, when viewed in light of the case presented to the jury, are eminently reconcilable. Accordingly, if this Court does not grant certiorari review, Petitioners will be deprived of their constitutional right to trial by jury.

The Tenth Circuit's holding conflicts with a well-established body of case law from this Court requiring courts to make every attempt to reconcile jury verdicts to protect the parties' Seventh Amendment right to trial by jury. In *Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines*, 369 U.S. 355, 359, 360, 364 (1962), this Court noted as follows:

> [N]either we nor the Court of Appeals can redetermine facts found by the jury any more than the

> District Court can predetermine them. For the Seventh Amendment says that 'no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.'
>
> . . . .
>
> As we recently stated in another diversity case, it is the Seventh Amendment that fashions 'the federal policy favoring jury decisions of disputed fact questions.' *Byrd v. Blue Ridge Rural Electric Co-op., Inc.*, 356 U.S. 525, 538, 539, 2 L.Ed.2d 953, 963, 78 S.Ct. 893 (1958).
>
> . . . .
>
> Where there is a *view of the case* that makes the jury's answers to special interrogatories consistent, they must be resolved that way. *For a search for one possible view of the case which will make the jury's finding inconsistent results in a collision with the Seventh Amendment.*

(Emphases added.) Thus, in *Atlantic & Gulf Stevedores*, this Court reversed the Third Circuit's determination that jury verdicts in a negligence case were inconsistent.

Similarly, in *Gallick v. Baltimore & Ohio Railroad Co.*, 372 U.S. 108 (1963), a Federal Employers' Liability Act case, this Court held that the state appellate court had improperly vacated a judgment entered on a jury verdict. In so doing, the Court noted that "the Court of Appeals improperly invaded the function and province of the jury" and that "*the record shows sufficient evidence* to warrant the jury's conclusion" (emphasis added). *Id.* at 112. The Court added that "it is the duty of the courts to attempt to harmonize [the jury's] answers, if it is possible under a fair

reading of them. . . . We therefore must attempt to reconcile the jury's findings, by exegesis if necessary, . . . before we are free to disregard the jury's special verdict and remand the case for a new trial." *Id.* at 119.

Accord Fairmont Glass Works v. Cub Fork Coal Co., 287 U.S. 474 (1933), in which this Court reversed a decision by the Seventh Circuit vacating a judgment entered on a jury verdict. The Court rejected the contention that a verdict in favor of plaintiff but awarding nominal damages was inconsistent, reasoning as follows:

> To regard the verdict as inconsistent on its face is to assume that the jury found for the plaintiff and failed to perform its task of assessing damages. The trial judge was not obliged so to regard the verdict. The defendant had insisted upon several defenses and had set up a counterclaim. The plaintiffs were not entitled to a directed verdict. The evidence was voluminous; and, on some issues at least, conflicting. The instructions left the contested issues of liability to the jury. The verdict may have represented a finding for the defendant on those issues; [footnote omitted] the reason for the award of nominal damages may have been that the jury wished the costs to be taxed against the defendant. . . . *Appellate courts should be slow to impute to juries a disregard of their duties, and to trial courts a want of diligence or perspicacity in appraising the jury's conduct.*

Id. at 484 (emphasis added). *See also Union Pacific Railroad Company v. Hadley*, 246 U.S. 330, 334 (1918) ("since the finding [by the jury] was *possible on the evidence* it cannot be attributed to disregard of duty. . . . Beyond the question of attributing misconduct to the jury we are not

concerned to inquire whether its reasons were right or wrong") (emphasis added).

In the present case, the Tenth Circuit failed to engage in the type of attempt to reconcile jury verdicts which is required by the above decisions of this Court. Had the Tenth Circuit conducted its inquiry under the proper standard, it would have found the verdicts to be consistent with Petitioners' theory of the case and reconcilable on that basis. Instead, the Tenth Circuit erroneously concluded that the verdicts were inconsistent.

As indicated by the above-cited portions of testimony, jury instructions, and argument of counsel, Petitioners contended, as one of two theories on their tort claim, that Respondent induced Petitioners to overinsure their property. Under this theory, utilizing the jury instructions on measure of damages, the jury could find that $256,000 was the proper amount to be awarded as damages on Petitioners' tort claim. By determining that Petitioners were entitled to prevail on their tort claim and recover the sum of $256,000, the jury clearly accepted Petitioners' "overinsurance" theory of the case. The District Court interpreted the jury's verdicts in this manner at the post-trial motions hearing.

The fact that the jury could have awarded the same dollar amount had it found in favor of Petitioners on the breach of contract claim does not make the two verdicts inconsistent, contrary to the Tenth Circuit's initial holding. This is because the two claims had distinctly separate elements of proof. *See, e.g., Diamond Shamrock Corp. v. Zinke & Trumbo, Ltd.*, 791 F.2d 1416, 1424 (10th Cir. 1986) (differing verdicts on contract and tort claims arising out of the same set of circumstances are not inconsistent when the verdicts follow the party's theory of the case).

In addition, in its decision on rehearing, the Tenth Circuit narrowly focused its inquiry on one of the jury instructions, to the exclusion of other portions of the case presented to the jury. Notably, the court did not supply any legal authority for its method of analysis in this regard. In fact, the above-cited decisions by this Court establish that the *case in its entirety* must be examined to determine whether the jury verdicts can be reconciled. Viewed in such manner, the record of the present case demonstrates that the jury followed the Petitioners' theory of the case by returning a general verdict in Petitioners' favor on their tort claim. In short, the jury's verdicts are not inconsistent.

The Tenth Circuit's decision can only be explained as a prohibited "search for one possible view of the case which will make the jury's finding inconsistent." *Atlantic & Gulf Stevedores*, 369 U.S. at 364. By contrast, the District Court, the judicial body possessing the greatest familiarity with the factual record, was able to reconcile the verdicts. The Tenth Circuit should have allowed the District Court's reconciliation of the verdicts to stand.

Upholding the jury's verdicts in this case would be especially appropriate in view of the lengthy proceedings predating the verdicts and the further delay which would occur if the verdicts were judicially undone. The trial in this case occurred nearly six years after Petitioners filed suit. As a result of the Tenth Circuit's decision, another trial must occur, followed by a possible third appeal.[3] These further

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[3] As noted in more detail *infra*, the Tenth Circuit's decision in its present form provides limited guidance to the District Court on how to proceed if this action is remanded for retrial. If, for example, the Court of Appeals intended that only the tort claim should be retried, a second jury verdict for Petitioners following retrial could generate a further (Footnote continued on next page)

proceedings could postpone resolution of this nine year-old case for at least another two years.[4]

Review on certiorari must be granted to correct the Tenth Circuit's erroneous holding and to preserve Petitioners' constitutional right to trial by jury.

B. The Tenth Circuit Erred in Permitting Respondent to Challenge the Consistency of the Verdicts on Appeal Despite Respondent's Failure to Raise the Issue Prior to Discharge of the Jury.

(Footnote continued from previous page)
appeal by Respondent, based on a contention that the verdict was inconsistent with the verdict in favor of Respondent on the breach of contract claim at the first trial. Surely such an "endless loop" is not consistent with considerations of judicial economy.

[4] Such undue delay violates the spirit and intent of the Civil Justice Reform Act of 1990, 28 U.S.C. §§ 471-482 (1990), which is replete with references to the need to reduce delay in resolution of civil disputes. In adopting such Act, Congress observed that delay in civil litigation "affects access to the courts, adjudication of cases on the merits, and the ability of the civil justice system to provide proper and timely judicial relief for aggrieved parties." Pub. L. No. 101-650, § 102(2), 104 Stat. 5089 (1990) (codified as note to 28 U.S.C. § 471). In addition, recent amendments to the Federal Rules of Civil Procedure adopted by this Court and Congress mandate avoidance of undue delay. As noted by the advisory committee regarding the amendment to Fed.R.Civ.P. 1:

> The purpose of this revision, adding the words 'and administered' to the second sentence, is to recognize the *affirmative duty of the court to exercise the authority conferred by these rules to ensure that civil litigation is resolved not only fairly, but also without undue cost* ***or delay***.

Fed.R.Civ.P. 1 advisory committee's note (emphases added).

A fundamental reason that the Tenth Circuit's decision should not stand is that Respondent waived its right to challenge the consistency of the jury's verdicts by failing to raise the issue prior to discharge of the jury. The circuit courts have consistently held that

> a party's failure to object to a verdict on the ground of inconsistency prior to the jury's discharge waives his right to raise the issue in a post-trial motion or on appeal unless the verdict is inconsistent on its face so that entry of judgment upon the verdict is plain error.

Diamond Shamrock, 791 F.2d at 1424. *Accord, e.g., United States Football League v. National Football League*, 842 F.2d 1335, 1367 (2d Cir. 1988) (where jury returns an "ambiguous verdict" and counsel "fails to seize the opportunity to raise an appropriate objection" before discharge of the jury, the party "waives the right to have the alleged inconsistencies remedied by a new trial"); *Itel Capital Corp. v. Cups Coal Co., Inc.*, 707 F.2d 1253, 1261 (11th Cir. 1983) (appellants waived objection to alleged inconsistencies in verdict through failure to object at the time the verdict was rendered); *Employers Casualty Co. v. Dupaquier*, 338 F.2d 336 (5th Cir. 1964) (in light of failure of party to move for resubmission of verdict to the jury, trial court's reconciliation of answer to special interrogatory with jury's general verdict affirmed).

The "waiver rule" fulfills important considerations of judicial economy. A contrary rule "would hamper the just and efficient operation of the federal courts" and "would encourage jury-shopping by litigants." *Diamond Shamrock*,

791 F.2d at 1422 (quoting *Cundiff v. Washburn*, 393 F.2d 505, 506, 507 (7th Cir. 1968)).[5]

In this case, Respondent did not raise the consistency issue until the post-trial motions stage, one month after the jury had been dismissed. Furthermore, there is no "plain error" in the verdicts, as they do not "reflect[] inconsistencies on [their] face indicating either that the jury was in a state of confusion or abused its power." *Diamond Shamrock*, 791 F.2d at 1423. "A verdict which resolves separate and distinct causes of action in favor of both parties to a lawsuit is not inconsistent on its face." *Id.* at 1424. To the contrary, the jury carefully followed Petitioners' theory of the case in finding in favor of Petitioners on their tort claim.

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[5] The policy underlying the waiver rule is also reflected in Fed.R.Civ.P. 49(b), pertaining to inconsistencies between general verdicts and special interrogatories. While such rule does not literally apply to the present case, it demonstrates the advisability of requiring alleged inconsistencies to be addressed at the trial court level. Rule 49(b) provides in pertinent part:

> When the answers [to special interrogatories] are consistent with each other but one or more is inconsistent with the general verdict, judgment may be entered pursuant to Rule 58 in accordance with the answers, notwithstanding the general verdict, or the court may return the jury for further consideration of its answers and verdict or may order a new trial. When the answers are inconsistent with each other and one or more is likewise inconsistent with the general verdict, judgment shall not be entered, but the court shall return the jury for further consideration of its answers and verdict or shall order a new trial.

The purpose of Rule 49(b) "is plain: to promote the efficiency of trials by allowing the original deliberating body to reconcile inconsistencies without the need for a new presentation of evidence to a different body." *Fernandez v. Chardon*, 681 F.2d 42, 58 (1st Cir. 1982).

The Tenth Circuit thus erred in permitting Respondent to challenge the jury verdicts on appeal. Furthermore, the Tenth Circuit's error was compounded through its failure to address the waiver issue on rehearing, although Petitioners raised the issue in their Petition for Rehearing. This Court should exercise its supervisory authority over the federal courts by granting certiorari review of the decision of the Court of Appeals.[6]

C. The Judgment of the District Court Should be Affirmed. If Remand is Necessary, the District Court Should Make More Detailed Findings on the Consistency Issue, or Should Retry Only the Damages Portion of the Tort Claim.

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[6] Respondent may contend that Petitioners waived their right to invoke the "waiver rule" because in their appeal brief submitted to the Tenth Circuit, Petitioners did not address the waiver rule issue *per se*, although Petitioners maintained that the jury verdicts were not inconsistent.

Respondent's argument, if advanced, should be rejected by this Court. Although an argument not raised in an appellate brief "[g]enerally" may not be raised for the first time in a petition for rehearing, *Costo v. United States*, 922 F.2d 302, 303 (6th Cir. 1990), the court has discretion to consider such an argument. *See, e.g., Granberry v. Greer*, 481 U.S. 129 (1987) (concerning nonexhaustion defense in habeas corpus proceeding); *Boardman v. Estelle*, 957 F.2d 1523 (9th Cir. 1992) (*Teague* (new rule) defense); and *United Transportation Union v. Dole*, 797 F.2d 823 (10th Cir. 1986) (statutory interpretation question concerning Hours of Service Act). Respondent lost its right to challenge allegedly inconsistent verdicts by failing to timely raise the issue before jury discharge. It cannot resurrect the argument because Petitioners did not deem the argument significant enough to devote appellate brief space to it. Furthermore, Petitioners specifically addressed the issue in its Petition for Rehearing. Furthermore, considerations of judicial economy mandate review of the waiver rule issue.

For the reasons described above, Petitioners respectfully submit that the verdicts returned by the jury in this case are not inconsistent and should not provide the basis for reversal or vacation of the District Court's judgment. This Court should, on certiorari review, reverse the Tenth Circuit's decision with instructions that the Tenth Circuit affirm the District Court judgment.

However, if this Court determines that this case should be remanded to the District Court for further proceedings, the remand should take one of two forms. First, this Court should direct that the District Court make more detailed findings concerning the consistency of the two verdicts. The District Court, based upon its familiarity with the evidence and the theories of liability, was able to reconcile the verdicts. On remand, the District Court could be instructed to make more detailed findings and conclusions to establish its basis for rejecting Respondent's contention that the verdicts are inconsistent. This would in turn provide a more effective basis for appellate review thereof and would expedite further proceedings in this action. *See Diamond Shamrock*, 791 F.2d at 1422 (the consistency issue should be determined within the discretion of the district court, subject to appellate review (citing *Cundriff*, 393 F.2d at 507)).

Alternatively, if remand is necessary, only the amount of damages relating to the tort claim should be retried. The jury found not only that all requisite elements of tortious conduct existed, but also found the tort to have been committed wilfully so as to warrant exemplary damages. The issue which apparently troubled the Tenth Circuit was the amount of compensatory damages awarded on the tort claim. Thus, even assuming for purposes of argument that the verdicts are inconsistent, such inconsistency at most reaches to the damages award on the tort claim.

Therefore, in the interest of judicial economy, if a retrial is required, it should encompass only the amount of damages which Petitioners are entitled to recover on their tort claim, since Respondent's liability on that claim and Petitioners' entitlement to punitive damages have already been established. Petitioners should only be required to prove on retrial the amount of their compensatory damages, punitive damages, interest, and attorneys' fees.

CONCLUSION

For the reasons stated herein, Petitioners respectfully request that this Court grant this Petition for a Writ of Certiorari.

Respectfully submitted,

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APPENDIX

APPENDICES

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

RICHARD MITCHELL AND LARRY COTTEN,	)	
Plaintiffs-Appellees,	)	No. 92-1208
v.	)	D.C. No. 86-S-2171
STATE FARM FIRE AND CASUALTY COMPANY,	)	[Filed February 1, 1994]
Defendant-Appellant.	)	

Appeal from the United States District Court
District of Colorado

Miles C. Cortez, Jr. (Stephen J. Hensen and Fermin G. Montoya of CORTEZ FRIEDMAN, P.C., with him on the brief), Denver, Colorado, for Plaintiffs-Appellees.

Alan Epstein of HALL & EVANS (William J. Hunsaker of MAKRIS, HUNSAKER, TOWEY & MELONAKIS, P.A., with him on the brief), Denver, Colorado, for Defendant-Appellant.

Before: LOGAN, Circuit Judge, FEINBERG, Senior Circuit Judge,* and McWILLIAMS, Senior Circuit Judge.

McWILLIAMS, Senior Circuit Judge.

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* Honorable Wilfred Feinberg, Senior Circuit Judge for the Second Circuit, sitting by designation.

This controversy has its genesis in a fire occurring on May 27, 1985, which totally destroyed a condominium located in Mt. Crested Butte, Colorado. At the time of the fire, the condominium was owned by Richard Mitchell and Larry Cotten ("Mitchell and Cotten"), and State Farm Fire and Casualty Company ("State Farm") had previously issued Mitchell and Cotten an insurance policy on the condominium for fire and extended coverage. A dispute between the insureds and the insurer thereafter arose, resulting in the present litigation.

On July 10, 1986, Mitchell and Cotten, both residents of Arkansas, along with their lender, the First National Bank of Fort Smith, Arkansas ("Bank"), brought an action in the United States District Court for the Western District of Arkansas against State Farm, an Illinois corporation qualified to do business in Colorado. Jurisdiction was based on diversity of citizenship. 28 U.S.C. § 1332(a)(1) (1993). Pursuant to 28 U.S.C. § 1404(a) (1993), the case was subsequently transferred to the United States District Court for the District of Colorado.

One of the plaintiffs' claims was for breach of an insurance contract.[1] The policy limits of the insurance policy at the time of the fire was $450,000, and plaintiffs sought judgment in that amount. By answer, State Farm denied that it was obligated to the plaintiffs in the sum of $450,000 for breach of contract, and alleged that under the terms of the

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[1] In their amended complaint the plaintiffs asserted six claims for relief, i.e. breach of duty of good faith and fair dealing, breach of contract, breach of fiduciary dities, consumer fraud, intentional infliction of emotional distress, and unfair and deceptive acts of practices in business, and sought judgment for $450,000 as "actual contract damages," as well as punitive damages.

policy it was only obligated to the plaintiffs for the actual cash value of the property at the time of the fire, which was less than $200,000.

Both sides moved for summary judgment on plaintiffs' breach of contract claim. In support of their motion for summary judgment, the plaintiffs argued that their breach of contract claim was governed by Arkansas law and that an Arkansas statute, Ark. Code Ann. § 66-3901 (Michie 1959) (now Ark. Code Ann. § 23-88-101(a) (Michie 1987)), referred to by the parties as a "valued policy" statute, provided as follows:

> A fire insurance policy, in case of a total loss by fire of the property insured, shall be held and considered to be a liquidated demand and against the company taking such risk, for the full amount stated in such policy, or the full amount upon which the company charges, collects or receives a premium.

In support of its motion for summary judgment, State Farm argued that Colorado law--not Arkansas law--was controlling, and that Colorado, unlike Arkansas, did not have a so-called "valued policy" statute, and, accordingly, the actual cash value provisions in the insurance contract controlled.

After a hearing, the district court granted plaintiff's motion for partial summary judgment and denied State Farm's motion, holding that the Arkansas statute governed. Therefore, the court found that under the "valued policy" statute of Arkansas, State Farm was obligated to pay plaintiffs the policy limits, namely $450,000.

On interlocutory appeal, we reversed the district court in *Mitchell v. State Farm Fire & Casualty Co.*, 902 F.2d 790 (10th Cir. 1990) ("*Mitchell I*"). In reversing, we held that

Arkansas' "choice of law" rules would dictate that Colorado law should apply since the insured property was located in Colorado. In so doing, we held that although State Farm was correct on the choice of law issue, we were not then considering, or deciding, whether under Colorado law plaintiffs were limited in their recovery to the actual cash value of the property at the time of the fire. As indicated, plaintiffs in the district court had asserted other and separate claims for relief against State Farm, but in *Mitchell I* we were only concerned with their claim based on the alleged breach of the insurance contract.

After remand, the case eventually came on for trial. As indicated, in their amended complaint the plaintiffs had asserted six claims for relief, two of which were submitted to the jury. The claims submitted to the jury were: (1) breach of the insurance contract and (2) breach of the duty of State Farm to deal in good faith and in fair dealing with the plaintiffs, the breach relied on by plaintiffs being the "delay" on the part of the State Farm in payment of the benefits due under the policy, which, under plaintiffs' theory of the case, was $450,000.

The jury returned a verdict in favor of State Farm on the breach of contract claim. However, as concerns plaintiffs' breach of duty claim, the jury returned a verdict in favor of the plaintiffs and against State Farm in the amount of $256,000. Judgment was thereafter entered in favor of the plaintiffs against State Farm in the amount of $256,000. The jury also returned a verdict in favor of the plaintiffs against State Farm in the amount of $10,000 as exemplary damages.

In post trial proceedings, the district judge also allowed plaintiffs $134,826.37 as prejudgment interest and awarded plaintiffs attorneys' fees in the sum of $79,978. State Farm appeals the judgment thus entered. Plaintiffs have not appealed the judgment in favor of State Farm on their breach

of contract claim. Accordingly, the jury's verdict in favor of State Farm on plaintiffs' breach of contract claim becomes the law of the case. *Mason v. Texaco, Inc.*, 948 F.2d 1546, 1553 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 1941 (1992).

A brief recital of the background facts will place the present controversy in better focus. On December 7, 1981, Mitchell and Cotten purchased a four-unit condominium complex (the subject property) located in Mt. Crested Butte, Colorado, from Yale and Kathleen Pokress for $255,000, the plaintiffs, *inter alia*, executing a promissory note in favor of the Pokress family in the amount of $130,000. At the time of the sale, the subject property was insured by the Pokress family with State Farm for $278,300. On December 7, 1981, State Farm consented to an assignment of the insurance policy from the Pokress family to the plaintiffs.

On May 27, 1982, the plaintiffs obtained a $385,000 line of credit from the Bank to draw against as needed to pay operating expenses, interest payments and eventually remodelling expenses on the subject property. The loan from the Bank was secured by a second deed of trust on the subject property, the plaintiffs having executed a first deed of trust in favor of the Pokress family in connection with the purchase of the property. The Bank required the plaintiffs to increase the policy limits of the policy of insurance whenever the loan balance exceeded the insurance coverage. Accordingly, State Farm, at the request of the plaintiffs, increased the policy limits on the subject property to $300,000 on January 18, 1983, and such was further increased to $450,000 in October 1984.

As above stated, the subject property was totally destroyed by fire on May 27, 1985. At the time, the subject property was security for the plaintiffs' then indebtedness to the Pokress family in the amount of $103,250 and to the

Bank in the sum of $384,690.09, making a total indebtedness in the amount of $480,940.09.

As indicated, it was plaintiffs' theory of the case that under the policy State Farm was obligated to pay plaintiffs $450,000. In contrast, State Farm's position was that, under the provisions of the policy if the subject property was totally destroyed by fire, it was only obligated to pay the "full cost of replacement." Furthermore, State Farm argued that if the property was not replaced within one year after the loss, which it was not, then State Farm was only obligated to pay the actual cash value of the subject property, which was considerably less than $450,000.

Laying aside, for the moment, the difference between the parties as to the amount due under the policy, investigation by authorities immediately after the fire disclosed that the fire was the result of arson. Accordingly, without going into great detail, State Farm refused to make any payment under the policy until it could determine if the plaintiffs were involved in the arson.

State Farm eventually concluded that it could *not* prove that the plaintiffs were connected with the intentional burning of the subject property, although, for whatever it is worth, it continued to believe that they had. In any event, on October 25, 1985, some five months after the fire, State Farm paid the Pokress family $113,164.18, which sum represented the plaintiffs' indebtedness to the Pokress family. In discharging plaintiffs' indebtedness to the Pokress family, State Farm took an assignment of the first deed of trust from Pokress.

During the pendency of Mitchell I, State Farm and the Bank entered into an agreement that if we reversed the district court, which we did, they would resolve their dispute through binding arbitration. Plaintiffs were not parties to this agreement. Accordingly, on April 30, 1991, nearly six years

after the fire, the arbitrators, after hearing, entered an award in favor of the Bank in the sum of $73,268, which sum represented the actual cash value of the property, less amounts paid by State Farm to the Pokress family, rather than payments up to the policy limit of $450,000, which the plaintiffs had demanded.[2] After State Farm satisfied the award to the Bank, under State Farm's theory of the case, nothing remained due and owing the plaintiffs. After the Bank received payment from State Farm, it withdrew the case.

As noted, the jury returned a verdict in favor of State Farm on plaintiffs' breach of contract claim, thereby adopting State Farm's position that its obligation under the contract was controlled by the provision that if the property was not replaced within one year it was only obligated to pay the actual cash value of the subject property as of the date of the fire, not the policy limit of $450,000.[3]

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[2] The arbitrators determined, *inter alia*, that the actual cash value of the building at the time of the loss, exclusive of the land value, was $172,000.00. In addition, there was an estimated personal property loss of $5,055.00.

[3] Apparently, at trial plaintiffs attempted to show that the written policy of insurance was changed or amended by an oral agreement between plaintiffs and a representative of State Farm wherein the policy limits were raised to $450,000, and that State Farm was obligated to pay that amount. In this regard, the jury was instructed that "[a] written contract may be changed or amended by oral agreement with the consent of all parties to the contract." The jury, by its verdict on the breach of contract claim, found that after crediting State Farm with the amounts paid to the Pokress family and the Bank, State Farm had discharged its obligation under the policy to the plaintiffs, and that it was not obligated to pay the policy limit, i.e., $450,000.

As stated, the jury returned a verdict in favor of the plaintiffs on their claim for breach of the duty of good faith and fair dealing in the sum of $256,000. The "duty" which plaintiffs relied on was the duty "not to delay payments due under the policy." That there was a delay is admitted by State Farm, but it is State Farm's position that any delay was, under the circumstances, reasonable. It is plaintiffs' position that the delay was unreasonable.

On appeal, State Farm urges several grounds for reversal, one of which is that the jury's verdict on plaintiffs' breach of duty claim is inconsistent with its verdict on plaintiffs' breach of contract award. As a result, State Farm contends that the verdict awarding plaintiffs the sum of $256,000 on their breach of duty claim should be vacated and a new trial ordered on that claim.

Colorado has recognized the tort of bad faith breach of an insurance contract, as distinguished from an action sounding in contract for breach of the contract itself. *Travelers Ins. Co. v. Savio*, 706 P.2d 1258 (Colo. 1985) (en banc); *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138 (Colo. 1984) (en banc). Accordingly, a judgment in favor of the insurer on a breach of contract claim does not necessarily foreclose recovery by an insured for damages caused by an insurer's bad faith delay of payments due under the policy.

However, notwithstanding our recognition of the distinction between a breach of contract action and an action sounding in tort for breach of the duty of good faith and fair dealing, we firmly believe the jury verdicts in this case are in conflict. The inconsistency we perceive in the instant case is that the jury found for State Farm on plaintiffs' claim for breach of contract, and then awarded plaintiffs $256,000 on their breach of duty claim. As both parties indicate, this can only be explained on the basis that in awarding plaintiffs $256,000 on their breach of duty claim, the jury

approximated the difference between the policy limit, $450,000, and the amounts paid by State Farm to the Pokress family and the Bank. However, by its verdict on plaintiffs' breach of contract claim, the jury at the same time found that State Farm had fulfilled its contractual obligation under the policy by its payment to the Pokress family and the Bank, and not only did *not* owe plaintiffs $450,000, but did not owe plaintiffs any amount. In other words, the jury, by its verdict on plaintiffs' breach of contract claim, found that State Farm did *not* owe plaintiffs $450,000, or any lesser sum, having discharged its contractual duty under the policy by its payments to the Pokress family and the Bank, and then, in the next breach, so to speak, found, in effect, that the measure of damage for plaintiffs' breach of duty claim approximated the difference between $450,000 and the amount paid by State Farm to the Pokress family and the Bank. We cannot "fairly harmonize" the two.[4] Evidence of other damage suffered by plaintiffs because of State Farm's delay in making payments to the Pokress family or the Bank was minimal.

Because of what we perceive to be an irreconcilable inconsistency between the jury's verdict on plaintiffs' breach of contract claim and its verdict on plaintiffs' breach of duty claim sounding in tort, the judgment in favor of plaintiffs on their breach of duty claim, including the judgment for punitive damages, prejudgment interest and attorneys' fees, is vacated and the matter remanded for further proceedings on the breach of duty claim. As indicated, there was no

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[4] A reviewing court will find jury verdicts inconsistent when it cannot "fairly harmonize" them. *Delano v. Kitch*, 663 F.2d 990, 999 (10th Cir. 1981).

appeal on that part of the judgment in favor of State Farm on plaintiffs' breach of contract claim. And such now stands as the law of the case.

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

RICHARD MITCHELL AND LARRY COTTEN,	)	
Plaintiffs-Appellees,	)	No. 92-1208
v.	)	D.C. No. 86-S-2171
STATE FARM FIRE AND CASUALTY COMPANY,	)	[Filed April 12, 1994]
Defendant-Appellant.	)	

Appeal from the United States District Court
District of Colorado

Opinion on Petition For Rehearing En Banc

Miles C. Cortez, Jr. (Stephen J. Hensen and Fermin G. Montoya of CORTEZ FRIEDMAN, P.C., with him on the brief), Denver, Colorado, for Plaintiffs-Appellees.

Alan Epstein of HALL & EVANS (William J. Hunsaker of MAKRIS, HUNSAKER, TOWEY & MELONAKIS, P.A. , with him on the brief), Denver, Colorado, for Defendant-Appellant.

Before: LOGAN, Circuit Judge, FEINBERG, Senior Circuit Judge,* and McWILLIAMS, Senior Circuit Judge.

McWILLIAMS, Senior Circuit Judge.

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* Honorable Wilfred Feinberg, Senior Circuit Judge for the Second Circuit, sitting by designation.

Mitchell and Cotten, appellees, filed a timely petition for rehearing, and, on order of Court, State Farm, the appellant, has now filed a response thereto.

In the petition for rehearing, counsel asserts that plaintiffs' claim for breach of the duty of good faith and fair dealing was based on two separate matters: (1) representatives of State Farm "induced and permitted" plaintiffs to overinsure the subject property; and (2) unreasonable delay in handling plaintiffs' claim. In this connection, counsel went on to state that "the panel failed to recognize . . . the plaintiffs' theory of defendant's bad faith predicated on the overinsurance and misleading conduct of State Farm's agent."

It is true that in their amended complaint plaintiffs did make a possible reference to overinsurance in their claim based on an alleged breach of the duty of State Farm to exercise good faith and fair dealing with the plaintiffs. It is also correct that in closing argument to the jury, counsel for the plaintiffs stated that both of the plaintiffs' claims, i.e., breach of contract and breach of duty, were based, in part, on "overinsurance" and "misleading conduct." In this regard, counsel did ask the jury to return verdicts in favor of the plaintiffs on both of their claims, i.e., breach of contract and breach of duty, and to fix their damages at $256,000 on each claim, assuring the jury, at the same time, that there would be only "one recovery." Notwithstanding, the jury was nonetheless instructed, without objection, that the plaintiffs' claim based on breach of duty of good faith and fair dealing was based on unreasonable delay by State Farm in making payments due under the policy.

Specifically, Instruction No. 23 reads as follows:

> In order for the plaintiffs to recover from the defendant on their claim of breach of

duty of good faith and fair dealing, you must find all of the following have been proved:

1. The plaintiffs incurred damages;

2. The defendant acted unreasonably in delaying payment on plaintiffs' claim without a legitimate basis for said delay;

3. The defendant knew its conduct was unreasonable or the defendant recklessly disregarded the fact that its conduct was unreasonable; and

4. The defendant's unreasonable conduct was a cause of the plaintiffs' damages.

If you find that any one or more of these four propositions has not been proved by a preponderance of the evidence, then your verdict must be for the defendant.

On the other hand, if you find that all of these four propositions have been proved by a preponderance of the evidence, then your verdict must be for the plaintiffs (emphasis added).

Under Instruction No. 23, the jury was instructed, in so many words, that plaintiffs' bad faith claim was based on unreasonable delay by State Farm of payments due plaintiffs under the policy. There is no mention in Instruction No. 23 of "overinsurance" or "misleading conduct." We do not regard "delayed payment" to be a synonym for "overinsurance" or "misleading conduct." All of which would suggest that the jury was confused and returned verdicts which cannot be "fairly harmonized."

Accordingly, appellees' petition for rehearing is hereby denied by the panel.

In accordance with Rule 35(b), Federal Rules of Appellate Procedure, the suggestion for rehearing en banc was transmitted to all of the judges of the court who are in regular active service. No member of the panel and no judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 86-S-2171

RICHARD MITCHELL AND LARRY COTTEN,

Plaintiffs,

v.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant.

VERDICT FORM B

We, the jury, find in favor of the defendant State Farm Fire and Casualty Company and against the plaintiffs Richard Mitchell and Larry Cotten on the claim of breach of insurance contract.

/s/	/s/
Linda J. Kleist	Robert P. Mills (foreperson)
/s/	/s/
Patricia H. Dopheide	James R. Gent
/s/	/s/
Herman J. Zindler	Jacquelyn R. Beavers
/s/	/s/
Merle E. Wolff	Darlene F. Seiffert

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 86-S-2171

RICHARD MITCHELL AND LARRY COTTEN,

Plaintiffs,

v.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant.

VERDICT FORM C

We, the jury, find in favor of the plaintiffs Richard Mitchell and Larry Cotten and against defendant State Farm Fire and Casualty Company on the claim of breach of duty of good faith and fair dealing and award actual damages in the amount of $256,000.

/s/
Linda J. Kleist

/s/
Robert P. Mills (foreperson)

/s/
Patricia H. Dopheide

/s/
James R. Gent

/s/
Herman J. Zindler

/s/
Jacquelyn R. Beavers

/s/
Merle E. Wolff

/s/
Darlene F. Seiffert

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 86-S-2171

RICHARD MITCHELL AND LARRY COTTEN,

Plaintiffs,

v.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant.

VERDICT FORM E

We, the jury, find in favor of the plaintiffs Richard Mitchell and Larry Cotten and against defendant State Farm Fire and Casualty Company on the claim for exemplary damages and award exemplary damages in the amount of $10,000.

/s/
Linda J. Kleist

/s/
Robert P. Mills (foreperson)

/s/
Patricia H. Dopheide

/s/
James R. Gent

/s/
Herman J. Zindler

/s/
Jacquelyn R. Beavers

/s/
Merle E. Wolff

/s/
Darlene F. Seiffert

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 86-S-2171

RICHARD MITCHELL AND LARRY COTTEN,

Plaintiffs,

v.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant.

JUDGMENT

This matter having come on regularly for trial on April 20, 1992, before the Court, the Honorable Daniel B. Sparr, Judge presiding and a jury of eight persons duly sworn to try the issues and the trial having proceeded to conclusion and the Court having duly instructed the jury and the jury having subsequently returned with its verdict as follows:

1) On plaintiffs claim for breach of insurance contract, the jury found in favor of defendant State Farm Fire and Casualty Company and against plaintiffs Richard Mitchell and Larry Cotten.

2) On plaintiffs' claim for breach of duty of good faith and fair dealing the jury found in favor of the plaintiffs Richard Mitchell and Larry Cotten and against defendant State Farm Fire and Casualty Company, and assessed damages in the amount of $256,000.00.

3) On the plaintiffs' claim for exemplary damages, the jury found in favor of the plaintiffs Richard Mitchell and Larry Cotten and against the defendant State Farm Fire and Casualty Company and assessed punitive damages in the amount of $10,000.00. It is therefore,

ORDERED that judgment shall hereby enter in favor of the defendant State Farm Fire and Casualty Company and against the plaintiffs Richard Mitchell and Larry Cotten on the breach of contract claim. It is

FURTHER ORDERED that judgment shall hereby enter in favor of the plaintiffs Richard Mitchell and Larry Cotten and against the defendant State Farm Fire Casualty Company in the amount of $256,000.00 on the breach of duty of good faith and fair dealing. It is

FURTHER ORDERED that judgment shall hereby enter in favor of the plaintiffs Richard Mitchell and Larry Cotten and against the defendant State Farm Fire and Casualty Company on the claim for exemplary damages in the amount of $10,000.00. It is

FURTHER ORDERED that pursuant to the stipulation of the parties that pre-judgment interest at the rate of 8% from October 1, 1985 to April 30, 1992 shall be awarded in the amount of $134,826.37 and judgment shall hereby enter for plaintiffs Richard Mitchell and Larry Cotten for said amount. It is

FURTHER ORDERED that post judgment interest shall accrue at the legal rate of 4.40% from the date of entry of judgment. It is

FURTHER ORDERED that the plaintiffs shall have their costs upon the filing of a Bill of Costs, pursuant to Local Rule 105, with the Clerk of the Court within 10 days of entry of judgment.

DATED at Denver, Colorado this 8th day of May, 1992.

Nunc Pro Tunc April 30, 1992.

FOR THE COURT:

JAMES R. MANSPEAKER,
Clerk

By: /s/
Stephen P. Ehrlich
Chief Deputy Clerk

APPROVED AS TO FORM:

/s/
Daniel B. Sparr, Judge
United States District Court

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Case No. 86-S-2171

RICHARD MITCHELL AND LARRY COTTEN,

Plaintiffs,

v.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant.

June 19, 1992
TRANSCRIPT OF POSTTRIAL MOTIONS

The above-entitled matter came on for posttrial motions before the HONORABLE DANIEL B. SPARR, U.S. District Court Judge, in Denver, Colorado, commencing at 1:35 p.m. on June 19, 1992.

THE COURT: The matter comes on this afternoon on several motions: defendant's renewed motion for judgment as a matter of law or, in the alternative, to amend judgment or for a new trial; defendant's motion for stay of execution; objection to fees.

(Tr., p. 2, ll. 10-14.)

. . . .

THE COURT: I guess you're saying, Well, if eventually the insurance company technically complies with the letter of the policy, you can't have a bad faith claim. I don't agree with that. I guess we disagree because I think you can have a bad faith claim even in the absence of --

MR. HUNSAKER [COUNSEL FOR RESPONDENT]: Your Honor --

THE COURT: -- the letter of the policy. And therefore, I don't see the inconsistency between the fact that they found no technical breach of the insurance contract but still found bad faith in the way it was handled.

(Tr., p. 13, l. 25-p. 14, l. 9.)

. . . .

THE COURT: Okay. The matter comes on for hearing on posttrial motions in this case; principally, the defendant's renewed motion for judgment as a matter of law or, in the alternative, to alter or amend judgment or for a new trial. With respect to the matters alleged therein, the Court makes the following conclusions and orders:

The Court rejects the fact that the plaintiff did not prove damages and the Court erroneously instructed the jury on damages, especially with respect to the Jury Instruction No. 30. Likewise, the Court rejects the argument that the verdict in this case is inconsistent on the matter of the fact that since the jury -- the allegation that the jury found that State Farm did not breach the contract and, therefore, State Farm could not owe the plaintiffs any damages for economic losses incurred as a result of the bad faith failure to exercise good faith.

The Court also rejects the arguments with respect to the evidence which was proven with respect to the reasonableness or unreasonableness of the conduct. I think that was all clearly matters for the jury. I think reasonable jurors could determine, as these jurors did, that the evidence did indicate that State Farm's conduct was unreasonable; that the evidence did indicate that the insurer acted in such a manner as to indicate a knowledge and reckless disregard of the fact that the valid claim had been submitted, in the

conduct of the insurer in handling the claim; and that the jurors, in fact, did determine that there was bad faith in delaying the processing of the claim and that the conduct of State Farm was unreasonable under the circumstances and that the insurer knew the conduct to be unreasonable or recklessly disregarded the fact that the conduct was unreasonable and notwithstanding the fact that the claim was technically never denied and the jury found that State Farm did not technically violate its insurance contract, they eventually paid the claim.

The Court still feels that the jury verdicts are not inconsistent. I think I dealt with the allegation that the plaintiffs did not prove that there was a reckless disregard or knowledge of the unreasonableness of the conduct.

As far as the punitive damages issue, that's a lot closer. I was inclined initially to look at the punitive damage issue with a calloused eye, if you please, in light of the mandates of Justice Kirschbaum in Savio and the burden of proof that he states there, notwithstanding the indications of the Court of Appeals -- and that was Judge Marquez, Sternburg, and Plank in Pierce versus Capitol Life -- and I think this is clearly the law -- that the establishment of a claim of bad faith breach of insurance contract alone is insufficient to establish a claim for punitive damages.

While the evidence is sufficient to warrant a submission of punitive damages issue to the jury, that is a question of law independent of whether or not a bad faith claim is -- evidence is sufficient to submit the claims to the jury. I'm going to let the punitive damages award stand. Candidly, I think that's a debatable question. Under the circumstances, I think there was sufficient evidence for a reasonable jury to consider that the insurer had knowledge of and recklessly disregarded the fact that a valid claim was submitted in their processing of the claim and knew their

conduct was unreasonable. That being the case, I'll allow the punitive damage claim to stand.

As far as the allegation that there was jury misconduct, I think I've addressed that sufficiently in colloquy, and I'll adopt by reference the comments in colloquy. The juror misconduct specifically involved a juror indicating to the courtroom deputy that she was having some difficulty with the other jurors during the course of the proceeding; she wanted to be excused because of her discomfort in dealing with the other jurors; because in the course of deliberations, she seemed to think she was prejudice against State Farm.

There were no requests for a mistrial or for the juror to even be excused. At the time, there was no objection stated to the Court's indication that it would not excuse the juror but merely admonish the courtroom deputy to indicate to the juror that she should not discuss the nature and status of the deliberations, which she'd been already admonished during the instructions.

I don't see any misconduct. I don't see any taint on the jury and certainly not enough to declare any plain error. I will not look into the state of mind of the juror, nor should I have looked into the state of mind at the time. It appears to be something that arose out of the heat of deliberation. The juror was simply advised to return and continue deliberations and not discuss the deliberations any further with the bailiff.

On the issue of the assessment of interest, I want to take another look at that, so I'll take that issue under advisement. I'm not going to give you any very comprehensive order on it. I think it's clearly a question of whether or not this matter has to be pled. I'm just a little uncomfortable yet with that, so I'll consider that at a later time. I want to take another look at it. I think both sides

concede that the statutory interest provisions of 13-21-101 don't apply.

(Tr., p. 43, l.8-p. 46, l. 24.)

Richard MITCHELL; Larry Cotten; First National Bank of Fort Smith, Arkansas, Plaintiffs-Appellees,

v.

STATE FARM FIRE & CASUALTY COMPANY, Defendant-Appellant.

No. 89-1192.

United States Court of Appeals,

Tenth Circuit.

April 25, 1990.

Insureds brought action to recover under fire policy. The United States District Court for the District of Colorado, Zita L. Weinshienk, J., held that Arkansas law was applicable, and appeal was taken. The Court of Appeals held that under Arkansas choice of law rules, Colorado law governed interpretation of fire policy covering Colorado property.

Reversed and remanded.

1. Federal Courts - 776, 870

Choice of law determinations are reviewed de novo; any findings of fact underlying such determinations are reviewed under clearly erroneous standard.

2. Action - 17

In determining which state's law is applicable to particular issue, court applying "most significant relationship" test should consider such general principles as needs of interstate and international systems, relevant policies of forum, relevant policies of other interested states and relative interests of those states in determination of particular issue, protection of justified expectations, basic

policies underlying particular field of law, certainty, predictability and uniformity of result, and ease in determination and application of law to be applied.

3. Contracts - 144, 276

In interpretation and enforcement of contract that does not contain choice of law provision, court applying "most significant relationship" test should consider such issues as place of contracting, place of negotiation of contract, place of performance, location of subject matter of contract, and domicile, residence, nationality, place of incorporation and place of business of parties.

4. Insurance - 147(1)

Under Arkansas choice of law rules, Colorado law governed interpretation of fire policy covering Colorado property, absent some special circumstance or other factor which would warrant departure from general rule that state in which property is located has most significant relationship to issues arising out of policy.

Phillip S. Figa (Emily Kahn Kemme with him on the briefs) of Burns & Figa, P.C., Denver, Colo., for plaintiffs-appellees.

Alan Epstein of Hall & Evans (William J. Hunsaker of Makris and Hunsaker, with him on the briefs), Denver, Colo., for defendant-appellant.

Before BRORBY, EBEL, Circuit Judges, and JOHNSON*, District Judge.

PER CURIAM.

Defendant-appellant State Farm Fire and Casualty Company (State Farm) appeals the trial court's grant of partial summary judgment to plaintiffs-appellees on the ground that Arkansas law, rather than Colorado law, governs determination of the amount due to plaintiffs under an insurance policy issued by State Farm on a Colorado property destroyed by fire. We reverse.

Facts

The following facts are undisputed unless otherwise noted:

On September 6, 1976, State Farm, an Illinois corporation, issued an insurance policy for fire and extended coverage (Policy) on a property described as Units 1, 2, 3 and 4, Westerly Condominiums (Property) in the town of Mt. Crested Butte, Colorado. The insureds under the Policy, which was issued and serviced out of State Farm's office in Englewood, Colorado, were Colorado residents. In late 1981, the Policy was assigned to plaintiffs-appellees Larry Cotten and Richard Mitchell in connection with their acquisition of the Property. Both Cotten and Mitchell are Arkansas residents. Plaintiff-appellee First National Bank of Fort Smith, Arkansas (FNB), which is the mortgagee on the Property and hence the principal Policy beneficiary, is also

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* Honorable Alan B. Johnson, District Judge, United States Distirct Court for the District of Wyoming, sitting by designation.

an Arkansas resident. The Policy does not indicate what state law governs issues regarding its operation and effect.

On May 27, 1985, the Property was totally destroyed by fire. Under the terms of the Policy, Mitchell and Cotten were entitled to the following recovery for this loss:

1. Replacement cost.

a. Unless otherwise specified, loss shall be adjusted on the basis of the replacement cost value of the property insured hereunder, but the limit of liability of the Company shall not exceed the least of:

(1) the full cost of replacement of such property at the same site with new material of like kind and quality, without deduction for depreciation;

(2) the cost of repairing the insured property within reasonable time;

(3) the limit of liability under this policy applicable to such property at the time of loss; or

(4) the amount actually and necessarily expended in repairing or replacing such property or any part thereof.

b. The Company shall not be liable for payment of loss on a replacement cost basis unless and until actual repair or replacement is completed.

Unless the time is extended by the Company in writing, loss to the property not repaired or replaced within one year after the loss will be settled on an actual cash value basis rather than on a replacement cost basis.

State Farm Policy No. 96-83-8571-2. The Property was not repaired or replaced within one year after the fire, allegedly because zoning and building ordinances adopted by the town of Mt. Crested Butte prior to the Property's destruction did not permit it to be rebuilt on its original foundation. State Farm's limit of liability under the Policy at the time of the fire was $450,000.

After the parties failed to reach an agreement as to the amount due to Mitchell and Cotten under the Policy, plaintiffs initiated this action against State Farm in the United States District Court for the Western District of Arkansas. This action was subsequent transferred to the federal district court for the District of Colorado pursuant to 28 U.S.C. § 1404(a).

In their complaint, plaintiffs alleged, among other things, that they were entitled to payment of $450,000, the maximum permitted under the Policy, rather than to the amount of the Property's actual cash value or replacement cost as stated in the Policy. In a March 31, 1988 motion for partial summary judgment on this issue, plaintiffs argued that this result was required by Arkansas' Valued Policy Statute, which states in pertinent part:

> A fire insurance policy, in case of a total loss by fire of the property insured, shall be held and considered to be a liquidated demand and against the company taking the risk, for the full amount stated in the policy, or the full amount upon which the company charges, collects or receives a premium . . . .

Ark. Code Ann. § 23-88-101 (1987) (formerly § 66-3901).

In a cross-motion for partial summary judgment filed soon thereafter, State Farm responded that Colorado rather than Arkansas law governed determination of the amount

due under the Policy and, further, that Colorado law required enforcement of the Policy as written and hence limited Mitchell and Cotten's recovery to the actual cash value of the Property. Both parties apparently agree that this value is approximately $200,000.

After a hearing, the district court granted plaintiffs' motion for partial summary judgment and denied State Farm's motion upon ruling Arkansas law governs this action and requires State Farm to pay plaintiffs the $450,000 limit of liability under the Policy. Order of November 7, 1988. On May 4, 1989, the district court granted the parties' stipulated motion for certification for appeal of its interlocutory order pursuant to 28 U.S.C. § 1292(b). This appeal followed upon our grant of State Farm's petition for leave to appeal.

Discussion

A. Standard of Review

[1] We review choice of law determinations *de novo*. *See Zipfel v. Halliburton Co.*, 832 F.2d 1477, 1482 (9th Cir. 1987), *cert. denied*, 486 U.S. 1054, 108 S. Ct. 2819, 100 L. Ed.2d 921 (1988). Any findings of fact underlying such determinations are reviewed under the clearly erroneous standard. *Id.* We will affirm the district court's grant of partial summary judgment on the choice of law issue only if it is clear from the record that there are no genuine issues of material fact and that plaintiffs are entitled to judgment as a matter of law. *Willner v. Budig*, 848 F.2d 1032, 1033-34 (10th Cir. 1988), *cert. denied*, — U.S. — 109 S. Ct. 840, 102 L. Ed.2d 972 (1989).

B. *Choice of Law*

The parties assert that either Arkansas or Colorado law governs determination of the amount due to plaintiffs under

the terms of the Policy and the circumstances of this case. It is undisputed that the law of these two states are in conflict on this issue and that the parties have not effectively chosen which state's law applies. Accordingly, we must determine which state's law governs this dispute. *See Coldwell Banker & Co. v. Karlock,* 686 F.2d 596, 599-600 & n. 4 (7th Cir. 1982). Because this diversity case was initiated in federal district court in Arkansas, Arkansas choice of law rules apply. *See Van Dusen v. Barrack*, 376 U.S. 612, 639, 84 S. Ct. 805, 820, 11 L. Ed. 2d 945 (1964).

[2] Arkansas generally applies the "most significant relationship" test to determine the applicable law in a conflicts situation. *See Standard Leasing Corp. v. Schmidt Aviation, Inc.*, 264 Ark. 851, 576 S.W.2d 181, 184 (1979); *Williams v. Carr,* 263 Ark. 326, 565 S.W.2d 400, 403-04 (1978); *Williams v. State Farm Mut. Auto. Ins. Co.*, 737 F.2d 741, 743 (8th Cir. 1984) (applying Arkansas law), *cert. denied,* 469 U.S. 1159, 105 S. Ct. 910, 83 L. Ed. 2d 923 (1985); *Roofing & Sheet Metal Servs., Inc. v. La Quinta Motor Inns, Inc.*, 689 F.2d 982, 994 (11th Cir. 1982) (summarizing Ark. law). This test, as stated in Section 6 of the Restatement (Second) of Conflict of Laws (1971) (Restatement), requires consideration of the following general principles in determining the state law applicable to a particular issue:

(a) the needs of the interstate and international systems,

(b) the relevant policies of the forum,

(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,

(d) the protection of justified expectations,

(e) the basic policies underlying the particular field of law,

(f) certainty, predictability and uniformity of result, and

(g) ease in the determination and application of the law to be applied.

Id.; see Williams v. Carr, 565 S.W.2d at 404.

[3] In a case such as this one, involving interpretation and enforcement of a contract that does not contain a choice of law provision

> the contracts to be taken into account in applying the principles of [the most significant relationship test] to determine the law applicable to an issue include:
>
> (a) the place of contracting,
>
> (b) the place of negotiation of the contract,
>
> (c) the place of performance,
>
> (d) the location of the subject matter of the contract, and
>
> (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.
>
> These contracts are to be evaluated according to their relative importance with respect to the particular issue.

Restatement § 188; *see Williams v. State Farm Mut. Auto. Inc. Co.*, 737 F.2d at 743 (applying § 188 contacts analysis

under Arkansas law); *Roofing & Sheet Metal Servs.*, 689 F.2d at 994-95 (same).

As suggested above, a particular contact may play an especially important role in determining the state having the most significant relationship to issues arising out of certain kinds of contracts. For contracts of fire, surety or casualty insurance, that contact is "the principal location of the insured risk during the term of the policy." Restatement § 193. Thus, in jurisdictions following the "most significant relationship" test, the law of the state in which the insured property, object or other risk is located normally governs issues concerning the validity or effect of the insurance contract, *see id.; Industrial Indem. Ins. Co. v. United States*, 757 F.2d 982, 986 (9th Cir. 1985); *Diamond Int'l Corp. v. Allstate Ins. Co.*, 712 F.2d 1498, 1501 (1st Cir. 1983); *McAllaster v. Bruton*, 655 F. Supp. 1371, 1373 (D. Me. 1987); *United States v. Aid Ins. Co.*, 642 F. Supp. 535, 537 (E.D. Mo. 1986), including "whether in the case of destruction or loss the insured's recovery will be limited to the actual value of the thing despite the fact that it was insured for a larger amount." Restatement § 193 comment a.

Although no Arkansas court has expressly adopted this rule in general or section 193 of the Restatement in particular, we agree with both the parties and the district court that the Arkansas Supreme Court would do so if given the opportunity. *See Roofing & Sheet Metal Servs.*, 689 F.2d at 994 (concluding, upon review of Arkansas case law, that the Arkansas Supreme Court would apply "most significant relationship" test to breach of contract issue); *cf. Bank of Oak Grove v. Wilmot State Bank*, 279 Ark. 107, 648 S.W.2d 802, 804 (1983) (holding that Arkansas law applies to all transactions involving lands within the state). Accordingly, we hold that the choice of law principles stated in

Restatement section 193 govern determination of the choice of law issue before this court.

In this case, the district court applied section 193 to hold, contrary to the general rule, that Arkansas had a more significant relationship to a determination of the plaintiffs' rights under the Policy than did Colorado, the location of the Property. As grounds therefor, the district court cited the plaintiffs' alleged expectation that the $450,000 policy limit was recoverable in case of total destruction of the Property, Arkansas' public policy, as evidenced by its Valued Policy Statute, that insureds be able to recover the full amount upon which they paid premiums and the fact that plaintiffs resided in Arkansas and negotiated and performed their obligations under the insurance contract there. Tr. at 32. In addition, the district court found that "the equities in this case strongly pointed to the application of the [more favorable] Arkansas law" because Mitchell and Cotten had paid premiums on a liability limit of $450,000 and had allegedly been unable to replace or repair the Property due to changes in Mt. Crested Butte zoning ordinances.[1] *Id.* at 30-32. Overall, the court found that "other than the [State Farm] agent residing in Colorado . . . and the property being actually located here . . . it seems to me all other relationships and all other significant tests would point to . . . the law of the state of Arkansas being applied in this case." *Id.* at 31.

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[1] It appears from the record before us that there was some dispute as to whether Mitchell and Cotten were precluded from rebuilding the Property or only from rebuilding on the original foundation. Because we reverse the district court's grant of partial summary judgment on other grounds, we need not address this question or any implications it might have for the plaintiffs' recovery under the Policy.

[4] We must disagree both with the district court's analysis and its conclusion. As the above discussion and vast majority of case law makes clear, the location of an insured property is not merely one factor to be balanced against others in determining the law governing the parties' rights under an insurance contract. Instead, it is the single most important factor in making this choice of law determination, *see, e.g.*, Restatement § 193; *Industrial Indem. Ins. Co.*, 757 F.2d at 986; *Diamond Int'l Corp.*, 712 F.2d at 1501-02; *McAllaster*, 655 F. Supp. at 1373; *Aid Ins. Co.*, 642 F. Supp. at 537, and, as the case law demonstrates, is almost invariably controlling.[2] Thus, absent some special circumstances or other factors distinguishing this case from those following the general rule, Colorado, as the state in which the Property is located, has the most significant relationship to issues arising out of the Policy and its law will govern this action.

Neither the record nor the district court's stated rationale in choosing Arkansas law justify a departure from the general rule in this case. There is no evidence in the record,

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[2] In fact, plaintiffs have found but a single case, *Coffin v. London & Edinburgh Ins. Co.*, 27 F.2d 616 (N.D. Ga. 1928), in which a court applied some law other than that of the state in which an insured property was continually located to determine the parties' rights under an insurance contract. In that case, the district court chose to apply the second state's law because application of the law of the state of location would have invalidated the insurance contract and thus defeated the expectations of both parties that a valid contract existed. *Id.* at 617-18. In this case, application of Arkansas law rather than the law of the state in which the Property is located would ahve the opposite effect because it would invalidate the liability clause of what otherwise appears to be a valid and binding contract. Thus, *Coffin* is readily distinguishable from this case.

for example, that the parties to this action either chose or expected, justifiably or otherwise, Arkansas law to govern issues arising under the Policy. In the absence of such evidence, it can generally be assumed that the parties, if they thought about the choice of law issue at all, expected Colorado law, as the law of the state in which the Property was located, to be applicable. *See* Restatement § 193 comment c. The fact that Arkansas law looks more favorably on plaintiffs' claim, and that plaintiffs would thus benefit from its application in this case, is also not determinative of which state has the most significant relationship to the recovery issue. *See Dorr v. Briggs*, 709 F. Supp. 1005, 1007 (D. Colo. 1989) (applying most significant relationsihp test to choose state law that potentially limited plaintiffs' recovery); *Grand Sheet Metal Prods. Co. v. Aetna Casualty & Sur. Co.*, 500 F. Supp. 904, 908-09 (D. Conn. 1980) (same). Finally, the fact that the insureds were Arkansas residents, and hence paid premiums and otherwise acted on the Policy from that base, is certainly not sufficient to overcome Colorado's interest in applying its law to an insurance contract on property located within its borders.

Accordingly, the district court's holding that Arkansas law governs determination of the amount of plaintiffs' recovery under the Policy is REVERSED, as is its order granting partial summary judgment to plaintiffs. Because there are no material issues of fact remaining and we have determined that State Farm is entitled as a matter of law to have Colorado law applied to the contract issues raised in this action, we also enter partial summary judgment for State Farm on this choice of law issue. We do not, however, consider or decide whether Colorado law limits plaintiffs' recovery under the Policy to the actual cash value of the Property as argued by State Farm in the district court below, but rather, consistent with the parties' stipulated motion

certifying this appeal, remand this issue to the district court for determination.

This matter is hereby REVERSED and REMANDED to the district court for further proceedings consistent with this decision and the district court's May 4, 1989, order certifying this appeal.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 86-S-2171

RICHARD MITCHELL, LARRY COTTEN, and THE FIRST NATIONAL BANK OF FORT SMITH ARKANSAS,

Plaintiffs,

v.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant.

ORDER [Filed November 7, 1988]

This matter was before the Court on November 3, 1988, for oral argument on plaintiffs' Motion for Partial Summary Judgment and defendant's Motion for Partial Summary Judgment. The Court heard the arguments and statements of counsel and made oral conclusions of law which are incorporated herein by reference as fully set forth. The Court found the Arkansas law applies on the value of the property at the time it was totally destroyed. Accordingly, it is

ORDERED that plaintiffs' Motion for Partial Summary Judgment is granted.

It is

FURTHER ORDERED that defendant's Motion for Partial Summary Judgment is denied.

DATED at Denver, Colorado, this 7 day of November, 1988.

BY THE COURT:

By: /s/
ZITA L. WEINSHIENK, Judge
United States District Court

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 86-S-2171

RICHARD MITCHELL, LARRY COTTEN, and THE FIRST NATIONAL BANK OF FORT SMITH ARKANSAS,

Plaintiffs,

v.

STATE FARM FIRE AND CASUALTY COMPANY,

Defendant.

ORDER CERTIFYING APPEAL UNDER 28 U.S.C. § 1292(b) [Filed May 4, 1989]

THIS MATTER having come before the Court upon the Stipulated Motion for 28 U.S.C. § 1292(b) Certification for Appeal of Interlocutory Order, and the Court having reviewed said Motion and being sufficiently advised in the premises, it is ordered that said Motion shall be and hereby is granted, and the Court hereby certifies its ruling of November 3, 1988 and its written Order of November 7, 1988 for appeal pursuant to 28 U.S.C. § 1292(b).

This case came on for hearing on the Motions for Partial Summary Judgment filed by the First National Bank of Fort Smith, Arkansas ("FNB") and by State Farm Fire and Casualty Company ("State Farm") on November 3, 1988. The Court made its ruling following that hearing, and entered its written Order November 7, 1988. The issue before the Court was whether the law of the State of Arkansas and the Arkansas Valued Policy Statute, Ark. Stat. Ann. § 66-3901, the state in which plaintiffs reside, was applicable to a fire insurance policy covering real property owned by Plaintiffs

Richard Mitchell ("Mitchell") and Larry Cotten ("Cotten") and on which FNB held a mortgage, or whether the law of the State of Colorado (the state in which the property is located) was applicable. Arkansas has a Valued Policy Statute which provides that the insurance company owes the full face value of the insurance policy limits whereas under Colorado law, there is no similar statute and the provisions of the policy would apply which arguably could limit the amount owed under the policy to the actual cash value of the property at the time of loss, upon its total destruction.

This Court determined that the law of the State of Arkansas was applicable because Arkansas has the most significant relationship to this cause of action, and that therefore the Arkansas Valued Policy Statute applied to the fire insurance policy. This Court hereby certifies that the issue decided at the hearing of November 3, 1988 and in its Order of November 7, 1988 involves a controlling question of law as to which there are substantial grounds for difference of opinion, and that an immediate appeal from such Order may materially advance the ultimate termination of this litigation. If the Court's Order is affirmed, FNB and State Farm have stipulated that judgment may enter as set forth in the stipulated motion filed by them. If the Court's rulin_ that Arkansas law is applicable to this case is found to be in error, and if it is determined that Colorado law is applicable as asserted by State Farm in its Motion for Partial Summary Judgment, FNB and State Farm have stipulated that any remaining issues between FNB and State Farm will be submitted to binding arbitration. In the event the matter is remanded for further proceedings, the matter shall proceed consistent with the determination of the appellate court.

DATED at Denver, Colorado this 3rd day of May, 1989.

BY THE COURT:

By: /s/
Zita L. Weinshienk
U.S. District Judge

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

RICHARD MITCHELL AND LARRY COTTEN,	)	
Plaintiffs-Appellees,	)	No. 92-1208
v.	)	D.C. No. 86-S-2171
STATE FARM FIRE AND CASUALTY COMPANY,	)	APPELLANT'S APPENDIX
Defendant-Appellant.	)	REPORTER'S TRANSCRIPT

Appeal from the United States District Court
District of Colorado
The Honorable Daniel B. Sparr

Alan Epstein of HALL & EVANS (William J. Hunsaker of MAKRIS, HUNSAKER, TOWEY & MELONAKIS, P.A. , with him on the brief), Denver, Colorado, for Defendant-Appellant.

Q: [BY COUNSEL FOR PETITIONERS] After purchasing the property and having it insured with State Farm, did you have an occasion to talk to Mr. O'Shea's office and request an increase in the amount of insurance coverage on the property?

A: [BY PETITIONER RICHARD MITCHELL] Yes, we did.

Q: Do you recall when the first conversation you had with Mr. O'Shea's office was?

A: No, I don't recall the first conversation. But--

Q: Do you remember how much you asked to have the insurance increased to?

A: Well, I remember that as the bank loan went up as we were using the money to get prepared to do our construction, whatever amount that we owed the bank -- because the bank would periodically call me and tell me that we did not have enough coverage on the property. That's when I would ask to -- in fact, I recall one conversation -- I don't remember which one it was -- that when I called the agent's office, I told him that we needed X number of dollars' worth of insurance and would he please go look at the unit and see if he could do that, I don't recall if that was the first time we increased the coverage or the second time.

Q: Do you recall what the agent said when you inquired as to whether he would increase the coverage and whether he got back to you after telling you he'd have to look at the units?

A: Well, I recall that a few days later, the agent called back and said there was no problem in increasing the coverage to the amount that I had requested and then they would send a new binder and a new premium notice to us.

Q: When you were talking to -- let me ask you this, Mr. Mitchell: The insurance agent you're talking about, was that somebody at Mr. O'Shea's office?

A: Yes, it was.

Q: When you were talking to Mr. O'Shea and requesting the increases in coverage, did you tell him why you needed the increased coverage?

A: Yes, I did.

Q: What did you tell him?

A: I told him that the bank wanted at all times for us to have adequate insurance on the property and in the event of a loss where their mortgage would be protected.

Q: And did you tell him that the mortgage on the property had increased and that's why you were requesting an increase in coverage?

A: Yes, I did.

Q: Let me direct your attention to Plaintiff's Exhibit 6; specifically, the second page, Mr. Mitchell. See at the top it indicates Declarations?

A: Yes.

Q: Do you see the area on the page where it indicates limits of liability for the building at $350,000?

A: Yes.

Q: Did you receive a copy of the second page of Plaintiff's Exhibit 6?

A: Yes, I'm sure I did.

Q: It's dated August 19th, 1983, signed by John O'Shea? Do you see that in the lower right-hand corner?

A: Yes.

Q: Is this the document you received from State Farm Fire and Casualty Company telling you the property was insured for $350,000?

A: Yes, apparently, it is.

Q: I draw your attention to the next page of Plaintiff's Exhibit 6. Would you tell me what that is.

A: It's an apartment policy, special -- something. I can't read that. It has a policy number. It has the limits of liability which is -- shows here $353,200.

Q: Could you please tell the jury whether you requested an increase from 350,000 to 353,200.

A: No, I didn't. I think this is one of State Farm's increases that they have every year on property.

Q: Could you tell the jury, please, what the date is on the third page of Plaintiff's Exhibit 6 in the lower right-hand corner.

A: Okay. 7-23-84.

Q: July 23, 1984?

A: Yes.

Q: Let me draw your attention to the fourth page of Plaintiff's Exhibit 6. Do you see that, Mr. Mitchell?

A: Yes.

Q: It indicates limits of liability at $450,000?

A: Yes.

Q: Did you request an increase in the coverage on the units from 353,000 to $450,000?

A: Yes, I did, because we had -- that's, apparently, what we owed on the loan at that time. And I think Mr. Foster with the bank had called and said that we were underinsured and that I needed to increase the coverage.

Q: When you say the loan, do you mean just the First National Bank loan or do you mean both the First National Bank and the Pokress loan?

A: No. The First National Bank loan.

Q: And you called up, again, Mr. O'Shea's office and asked an increase in coverage?

A: Yes.

Q: Could you tell the jury whether, during any of these conversations with Mr. O'Shea's office, Mr. O'Shea or whoever you were talking to at his office said anything to you about a replacement cost estimate that Mr. O'Shea had performed indicating a replacement cost of the units of $158,000?

A: No, never.

(Appellant's Appendix Reporter's Tr., Vol. II, p. 95, l. 22-p. 99, l. 21) (Trial Proceedings, April 21, 1992.)

. . . .

Q: [BY COUNSEL FOR PETITIONERS] When you purchased the property in Mount Crested Butte, how did you arrange to have it insured?

A: [BY PETITIONER LARRY COTTEN] When we came to the loan closing, one of the first questions that was asked of us was, you know, Who do you have it insured with? We had not discussed insurance at that time, so we asked the people we were purchasing the property from who they had their insurance with. And it was explained to us they had it with an agent named John O'Shea with State Farm Insurance Company. And so we called Mr. O'Shea from the title company, and he bound the property at that time. We assumed that policy that the Pokresses had had. They were the previous owners.

Q: Could you please explain to the jury, Mr. Cotten, what your purpose was for obtaining insurance on the property.

A: It's the same purpose that you always obtain insurance. Number one, it's required by the lender. But also, you want to protect your lender. And number two, you want to protect your own investment should, in fact, you have something -- a calamity -- happen.

(Appellant's Appendix Reporter's Tr., Vol. III, p. 256, l. 24-p. 257, l. 17.) (Trial Proceedings, April 22, 1992.)

. . . .

Q: [BY COUNSEL FOR PETITIONERS] Professor Allen, on the break, you placed some information on the easel. Please explain to the jury the items you placed on the easel.

A: [BY GARTH ALLEN, PETITIONERS' EXPERT WITNESS] Yes. I placed on the easel the items in response to your question of areas of unreasonable conduct in that -- things that State Farm did that were inconsistent with standards and practices and customs in the industry as I had outlined them.

The first thing -- I simply abbreviated "sold too much." And I noted here agent information that is in the claims file from the agent's file. And in 1983 the agent had done an appraisal of the property and noted that the property, pursuant to the agent's appraisal, had a value of $158,000.

On the face of that appraisal, however, the property has a history also identified in the claims file. My observation from the claims file was that in December of 1981 when the property was acquired, it was initially insured for 278,000. In January of '83, that insurance was increased to 300,000. In August of '83, it went up to 350,000. And in October of '84, 13 months later, it went up another hundred thousand to $450,000.

The "sold too much" simply means when the insurance company knows that they're valuing at 158,000 and, therefore, even in the event of a total loss, would not pay more than

158,000, it's improper to sell 450,000 and collect a premium on 450,000. Relatively simple to inform the insured, You're buying too much coverage. You're wasting your premium dollar. And that's my criticism.

The second area is delay. I just go through them, Mr. Hensen?

Q: Please do.

A: Delay from the time -- the fire happened on May 26th of '85. On May 26th of '85 -- and it was until -- 3-21-86 until they offered to pay Mr. Mitchell and Mr. Cotten anything.

(Appellant's Appendix Reporter's Tr., Vol. III, p. 368, l. 2-p. 369, l. 9.) (Trial Proceedings, April 22, 1992.)

. . . .

Q: [BY COUNSEL FOR PETITIONERS] Finally, Mr. Miller, and most importantly, if the insurance company has actual knowledge that the policy limits on a property it insures are much higher than the property is worth, isn't it true that the company has an obligation to tell the insured that it won't insure the property at the higher policy limits?

A: [BY J. KENT MILLER, RESPONDENT'S EXPERT WITNESS] You're speaking in general, not specifically in this case?

Q: Yes.

A: In general, if the insurance company -- the insurance company knows the insured is attempting to overinsure the property, the company has an obligation not to participate in that.

Q: It has a duty to tell them?

A: Yes. Assuming (a) the company knows there's an attempt to overinsure it, yes.

Q: And what the insurance company has a duty to do in that situation is to tell the insured something like this, quote, We won't take your premium because we'll never pay that much. You are wasting your money to pay that kind of premium. And more important, we don't want you to think that if there's a fire, we're going to pay anything like that? An insurance company has a duty to tell their insureds that; isn't that true?

A: Yes, if they know there's an attempt to overinsure the property.

(Appellant's Appendix Reporter's Tr., Vol. VII, p. 877, l. 9-p. 378, l. 7.) (Trial Proceedings, April 28, 1992.)

. . . .

[BY PETITIONERS' COUNSEL] Now let's get to the second claim for relief, ladies and gentlemen. And this is one that we should all take some heart in. Stop to think of the significance of this. In every insurance contract -- it's in yours and mine and everybody's -- there is an implied duty of good faith and fair dealing. Every insurance company is obligated by law, as Judge Sparr just instructed you, to treat their customers, to treat their insureds, in good faith and fairly.

Most of this case, ladies and gentlemen, was spent in showing just how badly these gentlemen were treated for the first year before this lawsuit was commenced -- in other

words, this lawsuit was commenced in July of 1986 -- and what brought them to finally throwing up their hands and saying, We can't handle it anymore. We have to bring our case to a jury like this so they can protect our interest, and then wait six more years to have their chance at justice.

Let's talk about how many instances of bad faith and unfair dealing were established in this case. One -- and I'll hit this one first because it's something we just talked about -- State Farm sold these gentlemen too much insurance. State Farm created in Larry Cotten and Richard Mitchell the false sense of security and peace of mind that they were protected. State Farm knew they weren't protected. State Farm knew they were going to try to do what they ended up doing in this case. How did they know that? Excuse me.

On November 4, 1983 -- I should have done this before we got started, and I apologize. I hope you can see this. By the way, ladies and gentlemen, what I'm going to show you will not be like the tall things, something the lawyers prepared that isn't evidence in this case. What I'm going to show you are exhibits which are evidence in this case.

First, let me show you Exhibit 42. What we've done here, ladies and gentlemen, so that there's no confusion, is -- this is a two-page letter-sized exhibit in this case. What we've done for your benefit is simply to put them all on one sheet and blow it up so it's a little bit easier for you to read.

This is actually a memo dated August 14, 1985, and it's done by Mr. Melander and Mr. Ehrsam during the course of Mr. Melander's investigation. But what I want to point out to you and which I've highlighted in yellow -- I don't know if you can see that where you are. I'll try to help you. You'll have the actual exhibit, by the way, in your exhibit notebooks when you go into your deliberations.

But you'll notice, ladies and gentlemen, that on November 4, 1983, John O'Shea -- this is information, by the way, from John O'Shea's file. And by the way, the whole file was never produced -- was not brought in. But this is Mr. Melander reviewing Mr. O'Shea's file. Look what it shows on November 4, 1983. John O'Shea determined that the replacement cost of the building that was destroyed by fire was $158,723. This includes an adjustment factor.

Then Mr. Melander was letting Mr. Ehrsam know, We've got a problem here, because on October 10, 1984, even though Mr. O'Shea knew this, additional coverage was requested by the insureds to $450,000, there's a small increased premium -- but here's the paragraph I want you to notice when you go into your deliberations because Mr. Melander, who is letting Mr. Ehrsam know they've got a problem -- that even though the insurance company knew they had this little of a replacement cost estimate, they were letting the insureds increase their coverage all the way to $450,000, creating that false sense of

security, even though State Farm knew that under its policy, it would never pay, according to the written word in the policy -- it would never pay more than the -- the lesser of replacement value or actual cash value.

So here this agent knew -- he knew on November 4, 1983 -- that the replacement cost was 158,000. When they called up and asked him for more insurance, he said, Sure, here, even though he knew what they were wanting it for. He went ahead, sold them that insurance, created that false sense of security. Now, why would an insurance company do that? More premiums. Why would the agent do it? More commissions.

You heard Professor Garth Allen testify about the elements of the breach of good faith and fair dealing. The first one, ladies and gentlemen, that Professor Allen pointed to, they sold them too much, let them believe that they were actually insured for that. Why is that important? If you had known back in 1983 that State Farm was never going to pay you even 350, much less 450,000 dollars, one, are you going to keep borrowing money and keep sinking it into this project? Are you going to keep running these risks? Are you going to let yourself get exposed to that? Of course not. You heard Professor Allen testify that it's an unfair practice and that it is unreasonable for an insurance company to do that type of thing, to sell you too much insurance.

Even Mr. Miller yesterday -- some of the most important testimony in this case came out yesterday during the cross-examination of Mr. Miller and, of course, Justice Neighbors. But let me show you how important Mr. Miller thought this was. You'll recall the questioning of Mr. Miller in which these questions were asked of Mr. Miller. When I was asking Mr. Miller, Isn't it true that an insurance company has a duty or an obligation to its insureds to advise them when it knows it won't pay out anywhere near the policy limit in the event of a total loss on a claim, given this independent evaluation of only $158,000, Mr. Mitchell -- excuse me -- Mr. Miller answered that, Yes, I think if the insurance company knows and has actual knowledge that the request from an insured to cover the property at certain face value -- that if the insurance company knows that the face value is much higher than the property is worth or will be worth in the course of remodeling or construction, the company has an obligation -- in fact, he even said it made good business sense to him. But the company should tell the insured, Look, we won't insure the property at that value. We won't take your premium because we'll never pay that much. You're wasting your money to pay that kind of premium. And more important, we don't want you to think that if there's a fire, that we're going to pay anything like that. That's what Mr. Miller said that State Farm should have done and should have told these gentlemen. Where's Mr. O'Shea?

> Where's Mr. O'Shea to testify that he did that?

(Appellant's Appendix Reporter's Tr., Vol. VIII, p. 1021, l. 12-p. 1025, l. 23.) (Trial Proceedings, April 29, 1992.)

. . . .

> [BY COUNSEL FOR PETITIONERS] On the breach of the duty of good faith and fair dealing, again, we're not looking to get more than they are entitled to, so we're going to start with the same cap of $450,000 and, again, giving them credit for 194,000, leaving a balance of 256,000.

(Appellant's Appendix Reporter's Tr., Vol. VIII, p. 1047, ll. 5-9.) (Trial Proceedings, April 29, 1992.)

INSTRUCTION NO. 14

In order for the plaintiffs Richard Mitchell and Larry Cotten to recover from the defendant State Farm Fire and Casualty Company on their claim for breach of the insurance contract, you must find that both of the following have been proved:

1. The defendant entered into a contract of insurance with the plaintiffs to insure the property in Mt. Crested Butte, Colorado; and

2. The defendant was obligated to pay the plaintiffs the amounts due pursuant to the terms of the contract.

If you find that either of these two propositions have not been proved by a preponderance of the evidence, then your verdict must be for the defendant.

On the other hand, if you find that both of these two propositions have been proved by a preponderance of the evidence, then your verdict must be for the plaintiffs, unless you shall also find that any of the defendant's affirmative defenses of:

1. plaintiffs' claims are barred because they have failed to comply with the conditions and requirements of the insurance policy; or

2. plaintiffs' claims are barred because defendant has paid all sums due and owing pursuant to the insurance policy;

have been proved by a preponderance of the evidence, in which event your verdict must be for the defendant.

INSTRUCTION NO. 22

If you find in favor of the plaintiffs on their claim of breach of insurance contract, then you must award them actual or nominal damages.

To award actual damages, you must find by a preponderance of the evidence that the plaintiffs incurred actual damages as a result of the breach, and the amount thereof.

To the extent actual damages have been proved by the evidence, you shall award as actual damages the difference between the amount you determine should have been paid under the policy of insurance and the amount the defendant has paid, not to exceed in the aggregate the amounts of liability under the insurance contract.

INSTRUCTION NO. 23

In order for the plaintiffs to recover from the defendant on their claim of breach of duty of good faith and fair dealing, you must find all of the following have been proved:

1. The plaintiffs incurred damages;

2. The defendant acted unreasonably in delaying payment on plaintiffs' claim without a legitimate basis for said delay;

3. The defendant knew its conduct was unreasonable or the defendant recklessly disregarded the fact that its conduct was unreasonable; and

4. The defendant's unreasonable conduct was a cause of the plaintiffs' damages.

If you find that any one or more of these four propositions has not been proved by a preponderance of the evidence, then your verdict must be for the defendant.

On the other hand, if you find that all of these four propositions have been proved by a preponderance of the evidence, then your verdict must be for the plaintiffs.

INSTRUCTION NO. 30

If you find in favor of the plaintiffs Richard Mitchell and Larry Cotton on their claim of breach of duty of good faith and fair dealing, you shall award as their actual damages, insofar as they have been proved by a preponderance of the evidence and insofar as they were caused by the defendant's breach of its duty of good faith and fair dealing, an amount which will reasonably compensate the plaintiffs for their damages, if any.

In determining such damages, you shall consider any economic losses incurred to the present time, including the difference between the amount you determine should have been paid under the policy of insurance and the amount the defendant has paid, not to exceed in the aggregate the amounts of liability under the insurance contract.

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

RICHARD MITCHELL AND LARRY COTTEN, *Plaintiffs-Appellees,* v. STATE FARM FIRE AND CASUALTY COMPANY, *Defendant-Appellant.*	No. 92-1208 D.C. No. 86-S-2171 PETITION FOR REHEARING AND SUGGESTION FOR REHEARING IN BANC

Appeal from the United States District Court
District of Colorado
The Honorable Daniel B. Sparr

[Filed Feb. 15, 1994]

/s/

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ATTORNEYS FOR PLAINTIFFS-APPELLEES RICHARD MITCHELL AND LARRY COTTEN

Plaintiffs-Appellees Richard Mitchell and Larry Cotten ("Plaintiffs") hereby submit their Petition for Rehearing and Suggestion for Rehearing In Banc pursuant to F.R.A.P. 35 and 40.

Plaintiffs respectfully submit that in its decision in this appeal, a panel of this Court overlooked or misapprehended key points of law and fact with regard to the consistency of the verdicts returned by the jury in this action. The jury found in favor of Defendant-Appellant State Farm Fire and Casualty Company ("Defendant") on Plaintiffs' breach of contract claim, and found in favor of Plaintiffs on their tort-based claim of breach of duty of good faith and fair dealing. The panel determined that these verdicts are inconsistent, thereby necessitating remand for a new trial. However, upon examination of relevant jury instructions, the case law, and closing argument of Plaintiffs' counsel, it is apparent that the verdicts are not inconsistent and indeed follow Plaintiffs' theory of the case on the tort claim. Under these circumstances, the Seventh Amendment of the U.S. Constitution and decisions of the United States Supreme Court and this Court mandate that the jury's verdicts be reconciled in order to preserve the parties' rights to trial by jury. Since the panel decision fails to reconcile verdicts which are reconcilable, rehearing is necessary.

Plaintiffs also respectfully suggest that rehearing in banc is warranted pursuant to F.R.A.P. 35. Prior decisions by this Court have mandated the reconciliation of jury verdicts whenever possible, making consideration by the full Court necessary to maintain uniformity of decisions by this Court on this issue. Furthermore, prior decisions of this Court have held that where, as here, an appellant failed to raise objections to allegedly inconsistent verdicts before the jury was discharged, such objections are waived. Given the

Seventh Amendment rights implicated by the right to trial by jury, as held by decisions of the U.S. Supreme Court and this Court, this appeal involves a question of exceptional importance. Plaintiffs thus request that this Court rehear this appeal in banc.

As further grounds for its petition, Plaintiffs state as follows:

RELEVANT PROCEDURAL HISTORY

Because the consistency of the jury verdicts is the central issue in the panel's decision, a brief summary of the record relating to the verdicts, and in particular Plaintiffs' tort claim, is required.

Plaintiffs' tort claim based upon the breach of duty of good faith and fair dealing was premised on Defendant's conduct in two respects: (1) inducing and permitting Plaintiffs to overinsure the property with the mistaken belief that in the event of total loss, their mortgagees (the Pokresses and the Bank) would be paid in full from policy limits, while State Farm knew that by virtue of a low appraisal which it had obtained, no such benefits would be paid; and (2) conducting an excessively long and malicious claim handling process with the intent to coerce Plaintiffs into abandoning their insurance claim or settling it for below its fair value. (Defendant's App., Vol. II at 95-99; Vol. III at 256-57 and 368-69; Vol. VII at 877-78; and Vol. VIII at 1021-25.)

With regard to Plaintiffs' breach of contract claim, the district court correctly (and without objection) instructed the jury as follows on the elements of the claim:

> In order for the plaintiffs Richard Mitchell and Larry Cotten to recover from the defendant State Farm Fire and Casualty

> Company on their claim for breach of the insurance contract, you must find that both of the following have been proved:
>
> 1. The Defendant entered into a contract of insurance with the plaintiffs to insure their property in Mt. Crested Butte, Colorado; and
>
> 2. The defendant was obligated to pay the plaintiffs the amounts due pursuant to the terms of the contract. (Instruction No. 14, Defendant's App. at 59.)

The jury received the following proper instruction on the claim of breach of duty of good faith and fair dealing, to which instruction there was no objection:

> In order for the plaintiffs to recover from the defendant on their claim for breach of duty of good faith and fair dealing, you must find all of the following have been proved:
>
> 1. The plaintiffs incurred damages;
>
> 2. The defendant acted unreasonably in delaying payment on plaintiffs' claim without a legitimate basis for said delay;
>
> 3. The defendant knew its conduct was unreasonable or the defendant recklessly disregarded the fact that its conduct was unreasonable; and
>
> 4. The defendant's unreasonable conduct was a cause of the plaintiffs' damages. (Instruction No. 23, Defendant's App. at 68.)

The jury was further instructed as follows with regard to the damages the jurors should award if they found in favor of Plaintiffs:

> If you find in favor of the plaintiffs on their claim of **breach of insurance contract**, then you must award them actual or nominal damages. To award actual damages, you must find by a preponderance of the evidence that the plaintiffs incurred actual damages as a result of the breach, and the amount thereof.
>
> To the extent actual damages have been proved by the evidence, you **shall award as actual damages** the difference between the amount you determine should have been paid under the policy of insurance and the amount the defendant has paid, not to exceed in the aggregate the amounts of liability under the insurance contract. (Instruction No. 22, Defendant's App. at 67) (emphases added.)
>
> * * *
>
> If you find in favor of the plaintiffs Richard Mitchell and Larry Cotten on their **claim of breach of duty of good faith and fair dealing**, you shall award as their actual damages, insofar as they have been proved by a preponderance of the evidence and insofar as they were caused by the defendant's breach of its duty of good faith and fair dealing, an amount which will reasonably compensate the plaintiffs for their damages, if any.
>
> In determining such damages, **you shall consider any economic losses incurred to**

> **the present time, including the difference** between the amount you determine should have been paid under the policy of insurance and the amount the defendant has paid, not to exceed in the aggregate the amounts of liability under the insurance contract. (Instruction No. 30, Defendant's App. at 75) (emphases added.)

Counsel for Plaintiffs, in closing argument, expanded upon the damages element of the above instructions as follows:

> On the breach of the duty of good faith and fair dealing, again, we're not looking to get more than they are entitled to, so we're going to start with the same cap of $450,000 and, again, giving them credit for 194,000, leaving a balance of 256,000. (Defendant's App., Vol. VIII at 1047.)

As described above, Plaintiffs' theory of the case on their tort claim contained two alternative components. In the event that the jury found that Defendant had breached the duty in the overinsuring context (the first theory described above), one measure of damages would have been $256,000, identical to the amount sought by Plaintiffs as damages for breach of contract. Thus, while the jurors were instructed on two distinct claims for relief, the measure of damages which they were to employ in either case could have been the same: the difference between the amount which Defendant should have paid under the insurance policy and the amount which Defendant actually paid, or the sum of $256,000 (exclusive of punitive damages, attorneys' fees, and costs).

The jury returned general verdicts against Plaintiffs on the breach of contract claim and in favor of Plaintiffs of the

claim of breach of duty of good faith and fair dealing. Defendant made no objections to the verdicts based on alleged inconsistency, or any other ground, before dismissal of the jury, and the jury was discharged. The district court entered judgment in the amount of $256,000 and awarded additional amounts to Plaintiffs for punitive damages, attorneys' fees, and costs.

Approximately one month after the trial, at a hearing on post-trial motions, counsel for Defendant raised for the first time the issue of alleged inconsistency of the jury verdicts. At an extensive hearing and argument on the post-trial motions, the district court reconciled the verdicts as follows:

> THE COURT: I guess you're saying, Well, if eventually the insurance company technically complies with the letter of the policy, you can't have a bad faith claim. I don't agree with that. I guess we disagree because I think you can have a bad faith claim even in the absence of --
>
> MR. HUNSAKER: Your Honor --
>
> THE COURT: -- the letter of the policy. And therefore, I don't see the inconsistency between the fact that they found no technical breach of the insurance contract but still found bad faith in the way it was handled. (Defendant's App., June 19, 1992 Transcript of Post-trial Motions at 13-14) (emphasis added.)

ARGUMENT

I. Rehearing Must Be Granted In Banc Because the Panel Did Not Adequately Attempt to Reconcile the Jury's Verdicts, Which are Not Inconsistent

The sole basis for the panel's reversal of the district court judgment was its holding that the verdicts were inconsistent.

The panel recognized that "a judgment in favor of the insurer on a breach of contract claim does not necessarily foreclose recovery by an insured for damages caused by an insurer's bad faith delay of payments due under the policy." Slip op. at 9. The panel failed to recognize, however, the Plaintiffs' theory of Defendant's bad faith predicated on the overinsurance and misleading conduct of State Farm's agent. Thus, the panel concluded that the jury's verdicts were inconsistent, holding as follows:

> The inconsistency we perceive in the instant case is that the jury found for State Farm on plaintiffs' claim for breach of contract, and then awarded plaintiffs $256,000 on their breach of duty claim. As both parties indicate, this can only be explained on the basis that in awarding plaintiffs $256,000 on their breach of duty claim the jury approximated the difference between the policy limit, $450,000, and the amounts paid by State Farm to the Pokress family and the Bank. However, by its verdict on plaintiffs' breach of contract claim, the jury at the same time found that State Farm had fulfilled its contractual obligation under the policy by its payments to the Pokress family and the Bank, and not only did *not* owe plaintiffs $450,000, but did not owe plaintiffs any amount. In other words, the jury by its verdict on plaintiffs' breach of contract claim found that State Farm did *not* owe Plaintiffs $450,000, or any lesser sum, having discharged its contractual duty under the policy by its payments to the Pokress family and the Bank,

> and then, in the next breath, so to speak, found, in effect, that the measure of damage for plaintiffs' breach of duty claim approximated the difference between $450,000 and the amount paid by State Farm to the Pokress family and the Bank. We cannot 'fairly harmonize' the two. (Slip op. at 9-10) (emphases in original.)

The panel's conclusion is factually and legally in error. As indicated by the above-quoted portions of the jury instructions and argument of counsel, Plaintiffs' theory of the case was that $256,000 could be a proper measure of damages under either of the two theories which went to the jury. By determining that Plaintiffs were entitled to prevail on their tort claim and recover the sum of $256,000, the jury precisely followed the jury instructions relating to the tort claim. The fact that the jury could have awarded the same dollar amount had it found in favor of Plaintiffs on the breach of contract claim does not make the two verdicts inconsistent, because **the two claims had distinctly separate elements of proof**.

The panel's decision conflicts with a well-established body of case law from this Court and the United States Supreme Court on the importance of making every attempt to reconcile jury verdicts. As noted by this Court in *Harvey by Harvey v. General Motors Corp.*, 873 F.2d 1343, 1347-48 (10th Cir. 1989):

> 'In fairness to trial courts and in order to preserve parties' Seventh Amendment rights, appellate courts 'struggle' to find a way of reconciling seemingly inconsistent interrogatory answers and verdicts' (*quoting Schaafsma v. Morin Vermont Corp.*, 873 F.2d

> 1343, 1347-48 (2d Cir. 1986)) . . . . There is no question that the trial and **appellate courts must attempt to reconcile rather than look for inconsistency in verdicts when such a question arises** (emphasis added).

See also Diamond Shamrock Corp. v. Zinke & Trumbo, Ltd., 791 F.2d 1416, 1431 (10th Cir. 1986) (McKay, J., concurring in part and dissenting in part):

> Not only the trial court, but this court as well, has a constitutional duty to reconcile apparent inconsistencies in the jury's verdicts, if at all possible, before we are free to disregard those verdicts . . . . Although the jury's verdicts could easily be construed as inconsistent, 'a search for one possible view of the case which will make the jury's finding inconsistent results in a collision with the Seventh Amendment' (*quoting Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines*, 369 U.S. 355, 364 (1962)).

In addition, as noted by the Supreme Court in *Atlantic & Gulf Stevedores*, the Seventh Amendment embodies "the federal policy favoring jury decisions of disputed fact questions." 369 U.S. at 360.

Furthermore, this Court has made it clear that jury verdicts are reconcilable if they fit with a party's theory of the case. *See Diamond Shamrock*, 791 F.2d at 1425 (where the verdicts "'tracked' the theory-of-the-case exactly as [plaintiff] invited it to be considered by the jury," the verdicts were not inconsistent; this Court further noted that a jury could find in favor of a party on a contract-based claim but against it on a related tort claim without returning

inconsistent verdicts). *See also Atlantic & Gulf Stevedores*, 369 U.S. at 364 (if there is a "view of the case" which makes the jury's findings reconcilable, the court **must** resolve the case in such manner); *accord Harris Market Research v. Marshall Marketing and Communications*, 948 F.2d 1518, 1522 (10th Cir. 1991).

In the present case, the panel did not adequately exercise its duty under the Seventh Amendment to reconcile the jury's verdicts if possible. The verdicts were eminently capable of reconciliation because the jury followed the district court's instructions to the letter in finding that Plaintiffs had suffered damages of $256,000 on their claim for breach of duty of good faith and fair dealing. The jury's verdicts were not inconsistent, and this Court must grant rehearing to rectify the error of the panel in this regard.

II. Rehearing Must Be Granted In Banc Because Defendant Waived Its Right to Challenge the Consistency of the Verdicts by Failing to Raise the Issue Prior to Discharge of the Jury

A fundamental reason that the panel's decision should not stand is that Defendant waived its right to challenge the consistency of the jury's verdicts by failing to raise the issue prior to discharge of the jury. It is well established in this Circuit that "a party's failure to object to a verdict on the ground of inconsistency prior to the jury's discharge waives his right to raise the issue in a post-trial motion or on appeal unless the verdict is inconsistent on its face so that entry of judgment upon the verdict is plain error." *Hinds v. General Motors Corp.*, 988 F.2d 1039, 1047 (10th Cir. 1993), *quoting Diamond Shamrock*, 791 F.2d at 1424; *accord Resolution Trust Corp. v. Stone*, 998 F.2d 1534, 1545 (10th Cir. 1993). A rule other than this waiver rule "would hamper the just and efficient operation of the federal courts" and "would

encourage jury-shopping by litigants." *Diamond Shamrock*, 791 F.2d at 1422, *quoting Cundiff v. Washburn*, 393 F.2d 505, 506, 507 (7th Cir. 1968).

In this case, Defendant did not raise the consistency issue until the post-trial motions stage, a month after the jury had been dismissed. Furthermore, there is no "plain error" in the verdicts, as they do not "reflect[] inconsistencies on [their] face indicating either that the jury was in a state of confusion or abused its power." *Diamond Shamrock*, 791 F.2d at 1423. "A verdict which resolves separate and distinct causes of action in favor of both parties to a lawsuit is not inconsistent on its face." *Diamond Shamrock*, 791 F.2d at 1424. To the contrary, the jury carefully followed the court's instructions in finding in favor of Plaintiffs on their tort claim. Defendant thereby waived its right to raise the issue on appeal. Unless rehearing in banc is granted, Defendant will be allowed to violate the waiver rule, contrary to substantial and recent precedent of this Court.

III. The Judgment of the District Court Should be Affirmed. If Remand is Necessary, the District Court Should Make More Detailed Findings on the Consistency Issue, or Should Retry Only the Damages Portion of the Tort Claim

For the reasons described above, Plaintiffs respectfully submit that the verdicts returned by the jury in this case are not inconsistent and should not provide the basis for reversal or vacation of the district court's judgment. This Court should, on rehearing, affirm the district court judgment. However, if this Court were to determine that this case should be remanded to the district court for further proceedings, the remand should take one of two forms.

First, this Court should request that the district court make more detailed findings concerning the consistency of the two verdicts. The district court, based upon its familiarity with the evidence and the theories of liability, was able to reconcile the verdicts, as set forth *supra*. However, on remand, the district court could be directed to make more detailed findings and conclusions to establish its basis for rejecting Defendant's contention that the verdicts were inconsistent. This would in turn provide a more effective basis for appellate review thereof. *See Diamond Shamrock*, 791 F.2d at 1422 (the consistency issue should be determined within the discretion of the district court, subject to appellate review). Such a limited remand would expedite further proceedings in this action, which has already lasted over eight years.[1]

Alternatively, if remand is necessary, only the amount of damages relating to the tort claim should be retried. As described above, the panel did not hold that the verdicts on the contract and tort claims were inconsistent with regard to Defendant's liability. Nor did the panel hold that the jury improperly awarded punitive damages based on the tort

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[1] Plaintiffs note that the panel's decision in its present form provides limited guidance to the district court on how to proceed. If, for example, the panel intended that only the tort claim should be retried, a second jury verdict for Plaintiffs following retrial could generate a further appeal by Defendant, based on a contention that the verdict was inconsistent with the verdict in favor of Defendant on the breach of contract claim at the first trial. Surely such an "endless loop" is not consistent with considerations of judicial economy.

claim. The jury found not only all elements of the tortious conduct, but found the tort to have been committed wilfully so as to warrant exemplary damages. The sole issue which troubled the panel was the amount of compensatory damages awarded on the tort claim. Thus, even assuming for purposes of argument that the verdicts are inconsistent, such inconsistency at most reaches to the damages award on the tort claim.

Therefore, in the interest of judicial economy, a retrial should only be required on the amount of damages which Plaintiffs are entitled to recover on their tort claim, since Defendant's liability on that claim and Plaintiffs' entitlement to punitive damages have already been established. Thus, Plaintiffs should only be required to prove on retrial the amount of their compensatory damages, punitive damages, interest, and attorneys' fees.

CERTIFICATION UNDER TENTH CIRCUIT RULE 35.2

The undersigned counsel express a belief based on a reasoned and studied professional judgment that the panel decision in this appeal is contrary to the following decisions of the Supreme Court or of the United States Court of Appeals for the Tenth Circuit, and consideration by the full court is necessary to secure and maintain uniformity of decisions in this court, pursuant to the following cases:

1. *Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines*, 369 U.S. 355 (1962)

2. *Resolution Trust Corp. v. Stone*, 998 F.2d 1534 (10th Cir. 1993)

3. *Hinds v. General Motors Corp.*, 988 F.2d 1039 (10th Cir. 1993)

4. *Harris Market Research v. Marshall Marketing and Communications*, 948 F.2d 1518 (10th Cir. 1991)

5. *Harvey by Harvey v. General Motors Corp.*, 873 F.2d 1343 (10th Cir. 1989)

6. *Diamond Shamrock Corp. v. Zinke & Trumbo, Ltd.*, 791 F.2d 1416 (10th Cir. 1986)

The undersigned counsel express a belief based on a reasoned and studied professional judgment that this appeal involve questions of exceptional importance, that is:

1. Did the panel decision fail to recognize the district court's discretionary reconciliation of the verdicts, or adequately attempt to reconcile the allegedly inconsistent jury verdicts as required by the Seventh Amendment, and controlling case law from this Circuit and the U.S. Supreme Court?

2. Did the panel decision permit the Defendant, which did not object to allegedly inconsistent verdicts until a month after the jury was discharged, to avoid the waiver rule mandated by the Seventh Amendment and controlling case law from this Circuit and the U.S. Supreme Court?

Respectfully submitted this 15th day of February, 1994.

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Supreme Court, U.S.
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AUG 11 1994
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No. 94-56

IN THE
Supreme Court of the United States
OCTOBER 1994 TERM

RICHARD MITCHELL and LARRY COTTEN,

Petitioners,

v.

STATE FARM FIRE and CASUALTY COMPANY,

Respondent.

OPPOSITION TO PETITION FOR
WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

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28 pp

QUESTION PRESENTED

1. Whether the United States Court of Appeals for the Tenth Circuit correctly held that the jury's award of $256,000 in actual damages on plaintiffs' bad faith breach of contract claim was irreconcilably inconsistent with its determination that State Farm did not breach the insurance contract, since, under the instructions given to the jury, and the evidence introduced at trial, the jury could not have awarded $256,000 pursuant to plaintiffs' bad faith claim.

PARTIES TO THE PROCEEDING

The names of all parties to the proceeding appear in the caption of this cross-petition. Pursuant to Sup. Ct. R. 29.1, cross-petitioner represents that State Farm Mutual Automobile Insurance Company is the parent company of State Farm Fire & Casualty Company.

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Appendix

Appendix A

Exerpts of Trial Transcript 1a

STATEMENT OF THE CASE

On September 6, 1976, State Farm issued an insurance policy for fire and extended coverage to Harry H. Hoesli, Jr. and Sarah P. Hoesli of Crested Butte, Colorado as insureds. The policy insured a building located on Castle Road in the town of Mount Crested Butte, Colorado.

On December 2, 1977 the State Farm fire insurance policy insuring this building was assigned to one Michael Pokress.

The building was subsequently purchased by Larry Cotten and Richard Mitchell for $255,000. State Farm consented to the assignment of this policy to Mitchell and Cotten. In connection with the purchase of the property, plaintiffs executed a promissory note to the Pokresses for $130,000. That note was subsequently extended several times.

At the time Mitchell and Cotten requested the assignment of the policy, the policy limit of coverage was $278,300. The policy coverage was increased to $300,000 on January 18, 1983, at the request of Mitchell and Cotten. Mitchell and Cotten requested that State Farm increase the policy limits because their bank, First National Bank of Fort Smith, Arkansas ("the Bank"), required them to do so as they were increasing their mortgage by taking advances on a construction loan on the property. The loan was secured by a second mortgage on the property in the amount of $385,000. The deed of trust on the property which secured the loan to the Bank also required that the insurance be increased to protect the loan.

The policy limits were subsequently increased on two occasions at the request of Mitchell and Cotten. Again, plaintiffs requested State Farm to increase the policy limits because of demands made on them by the Bank as the result of additional funds advanced on the construction loan.

By the time of the arson fire, plaintiffs had taken advances of virtually the entire amount loaned by the Bank and had spent it, but had not done any construction on the property. At the time of the fire, plaintiffs owed approximately $500,000 in loans secured by the property.

On May 27, 1985, the property was totally destroyed by fire. It is undisputed the fire was caused by arson. During the investigation of the claim, State Farm paid the holder of the first mortgage $113,164 in full payment of the note and took an assignment of the note and deed of trust as provided for in the insurance policy. State Farm also paid the insureds for debris removal and demolition under the policy. After the parties failed to reach an agreement as to the amount to which plaintiffs were entitled under the policy and after State Farm invoked the appraisal process, plaintiffs initiated this action in the Western District of Arkansas, Fort Smith Division C, demanding policy limits under the Arkansas valued policy statute. The case was subsequently transferred to the United State District Court for the District of Colorado pursuant to 28 U.S.C. § 1404(a).

Cross-motions for partial summary judgment were filed by both parties regarding whether Arkansas or Colorado law applied with respect to the amount plaintiffs were entitled to recover under the policy. State Farm's position was that Colorado law applied with respect to the amount of recovery available under the insurance policy, and that plaintiffs were limited to recovering the actual cash value of the property.

Plaintiffs' position was that Arkansas law applied with respect to the amount of recovery available and that Arkansas' "valued policy" statute permitted them to recover the policy limits. Ark. Stat. Ann. § 66-3901, now Ark. Stat. Ann. § 23-88-101 (1987).

The district court ruled that Arkansas law applied and that, therefore, plaintiffs were entitled to recover $450,000 rather than the actual cash value of the property. The district court granted the parties' stipulated motion for certification for appeal of interlocutory order pursuant to 28 U.S.C. § 1292(b). The Tenth Circuit Court of Appeals granted State Farm's petition for permission to appeal on June 26, 1989.

The Tenth Circuit reversed the district court's order in *Mitchell v. State Farm Fire & Cas. Co.,* 902 F.2d 790 (10th Cir. 1990) ("*Mitchell I*") and held that Colorado law applied.

After the Tenth Circuit reversed the district court's decision, and pursuant to the appraisal provision of the insurance policy, the issue as to the additional amount, if any, to which the Bank, as holder of the second mortgage was entitled, was submitted to arbitration. The amount of the second mortgage exceeded the policy limits and therefore no amounts would have been payable to the insureds. The arbitrators made an award based on the actual cash value of the property less amounts paid by State Farm to the holder of the first mortgage, and for debris removal and clean-up, and awarded the Bank $73,268, rather than the policy limits of $450,000 which plaintiffs had demanded. State Farm satisfied the award to the Bank and nothing remained owing to plaintiffs.

Plaintiffs' claims against State Farm for breach of contract and bad faith breach of insurance contract proceeded to trial. The jury rendered a verdict in State Farm's favor on plaintiffs' breach of insurance contract claim. However, the jury rendered a verdict in plaintiffs' favor on their bad faith breach of insurance contract claim. The jury assessed compensatory damages in the amount of $256,000, the difference between the amount that was paid by State Farm pursuant to the policy, and the policy limits of $450,000.

State Farm then appealed to the Tenth Circuit on several bases, including the contention that the jury's verdict findings that State Farm did not breach the insurance contract, yet breached the insurance contract in bad faith, were irreconcilably inconsistent. The Tenth Circuit reversed the district court's entry of judgment in plaintiffs' favor. *Mitchell v. State Farm Fire & Cas. Co.,* 15 F.3d 959 (10th Cir. 1994) (*Mitchell II*). The Court disagreed with State Farm's argument that the jury verdict findings that State Farm did not breach the contract, yet was in bad faith, were not irreconcilably inconsistent. 15 F.3d at 962. However, the Court perceived a different inconsistency in the jury's verdicts.

The Court held that the jury finding for State Farm on plaintiffs' claim for breach of contract, and then awarding plaintiffs $256,000 on their bad faith claim was inconsistent because no evidence was introduced that plaintiffs sustained $256,000 in damages as the result of any delay in payment of their claim. The Court therefore vacated the judgment entered in plaintiffs' favor and reversed with instructions to retry the bad faith claim.

Plaintiffs then filed a petition for rehearing and suggestion for rehearing en banc. Plaintiffs argued that the jury's verdicts were not irreconcilably inconsistent because the jury could have awarded them $256,000 in damages based on their "overinsurance" theory of bad faith liability, rather than their "delay" theory of liability.

The Tenth Circuit denied plaintiffs' petition for rehearing and suggestion for rehearing en banc. *Mitchell v. State Farm Fire & Cas. Co.,* 20 F.3d 395 (10th Cir. 1994). The Court reasoned that, although plaintiffs alluded to an "overinsurance" theory of liability at trial, the jury was only instructed that plaintiffs could recover on their claim of breach of duty of good faith and fair dealing if it found that State Farm unreasonably delayed payment of plaintiffs' claim. Because this bad faith instruction directed plaintiff to a specific theory of liability upon which plaintiffs did not introduce evidence indicating $256,000 in damages, the Court confirmed its initial holding that the jury verdicts were irreconcilably inconsistent.

Plaintiffs' petition for certiorari follows.

SUMMARY OF ARGUMENT

Because the jury was instructed that it could find State Farm liable for breach of the duty of good faith and fair dealing only with respect to plaintiffs' "delay" theory of liability, the Tenth Circuit correctly concluded that the jury's verdicts could not be "fairly harmonized" and, therefore, were irreconcilably inconsistent.

Further, plaintiffs' "overinsurance" theory of liability was meritless under the circumstances presented in this case since plaintiffs themselves, not State Farm, overinsured the property by failing to use their construction loans to improve the property.

Since plaintiffs did not raise their argument that State Farm waived its "inconsistent verdicts" issue until plaintiffs' petition for rehearing, plaintiffs are precluded from raising this issue in their petition for certiorari.

Assuming the Tenth Circuit correctly reversed and remanded with instructions to retry the bad faith claim, a retrial on both liability and damages is mandated.

REASONS FOR NOT GRANTING THE PETITION

A. The Tenth Circuit Correctly Concluded that the Jury Verdicts Were Irreconcilably Inconsistent

Plaintiffs correctly contend that an appellate court must attempt to reconcile jury verdicts, and where there is a view of the case that make the jury's answers to special interrogatories consistent, they must be resolved that way. *Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines,* 369 U.S. 355, 82 S. Ct. 780, 7 L.Ed.2d 798 (1962); *also see Gallick v. Baltimore & Ohio Railroad Co.,* 372 U.S. 108, 83 S. Ct. 659, 9 L.Ed.2d 618 (1963). However, a reviewing court will find jury verdicts inconsistent when it cannot "fairly harmonize them." *Delano v. Kitch,* 663 F.2d 990, 999 (10th Cir. 1981).

Plaintiffs contend that the jury verdict holding State Farm liable for bad faith and awarding them $256,000 in damages, while also finding that State Farm did not breach the insurance contract, can be reconciled because the jury could have awarded these damages pursuant to its "overinsurance" theory of bad faith, rather than their "delay" theory of bad faith. Assuming that plaintiffs' "overinsurance" theory of bad faith had merit (which, as discussed elsewhere, it did not), plaintiffs' argument is incorrect because it ignores the fundamental tenet of appellate

review that required the Tenth Circuit, and requires this Court, to assume that the jury followed its instructions in this case.

The theory under which jury instructions are given by the trial courts and reviewed on appeal is that juries act in accordance with the instructions given them. *City of Los Angeles v. Heller,* 475 U.S. 796, 106 S. Ct. 1571, 89 L.Ed.2d 806 (1986). A reviewing court must assume that the jurors followed the law as given by the court, *Lloyd v. Grynberg,* 464 F.2d 622 (10th Cir. 1972), and also assume that the jurors attend closely the particular language of the trial court's instructions and follow those instructions. *Williams v. United States Elevator Corp.,* 920 F.2d 1019 (D.C. Cir. 1990).

The jury was instructed as follows with respect to plaintiffs' claim for breach of duty of good faith and fair dealing:

> In order for the plaintiffs to recover from the defendant on their claim of breach of duty of good faith and fair dealing, you must find all of the following have been proved:
>
> 1. The plaintiffs incurred damages;
>
> 2. *The defendant acted unreasonably in delaying payment on plaintiffs' claim without a legitimate basis for said delay;*
>
> 3. The defendant knew its conduct was unreasonable or the defendant recklessly disregarded the fact that its conduct was unreasonable; and
>
> 4. The defendant's unreasonable conduct was a cause of the plaintiffs' damages.
>
> If you find that any one or more of these four propositions has not been proved by a preponderance of the evidence, then your verdict must be for the defendant.
>
> On the other hand, if you find that all of these four propositions have been proved by a preponderance of

> the evidence, then your verdict must be for the plaintiffs. (Emphasis added)

Since the jury found for plaintiffs on their claim of breach of the duty of good faith and fair dealing, it must be presumed it followed this instruction in reaching this conclusion. *City of Los Angeles v. Heller, supra.* The jury was not instructed that it could find for plaintiffs if it determined that defendant acted unreasonably in delaying payment on plaintiffs' claim *or* that it acted unreasonably in "overinsuring" the property. It is irrelevant that plaintiffs argued to the jury their "overinsurance" theory of bad faith; the specific instructions precluded the jury from predicating liability on that theory. Because the foregoing instruction was not general in nature and restricted liability to one of the theories of bad faith presented by plaintiffs, the jury could not, under its instructions, predicate liability on any theory other than plaintiffs' "delay" theory.

Contrasting the jury instructions in this case with the jury instructions in *Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines, supra* illustrates the fallacy of plaintiffs' argument. There, the plaintiff predicated negligence on several theories of liability after being injured while helping to discharge bales of burlap from a vessel. The jury instruction concerning liability instructed the jury to determine "whether or not there was a reasonably safe discharge" of the cargo. This Court held that the jury instruction was general in nature and permitted the jury to consider the totality of the circumstances in determining the defendant's liability. Therefore, this Court held that the jury verdicts could be reconciled.

In contrast, here, the jury was not permitted to consider the "totality of circumstances" in determining whether State Farm was liable for breach of the duty of good faith and fair dealing. Rather, it was specifically instructed that it could find liability on this theory if State Farm acted unreasonably in delaying payment on plaintiffs' claim. The only logical inference the jury could draw from this instruction is that it could not predicate liability on any other of plaintiffs' theories.

Since, as the Tenth Circuit held, and plaintiffs do not contest, the jury could not have awarded $256,000 in damages based on any delay in paying their claim, the jury's verdict finding that State Farm acted in bad faith in allegedly delaying payment of their claim, yet awarding them $256,000 in damages, cannot be "fairly harmonized." Consequently, the Tenth Circuit correctly held that the jury's verdicts were irreconcilably inconsistent. *See Delano v. Kitch, supra.*

B. Plaintiff's "Overinsurance" Theory of Bad Faith Liability was Meritless as a Matter of Law Under the Circumstances Presented in This Case

Additionally, plaintiffs' "overinsurance" theory of liability was utterly meritless and should not have been submitted to the jury in the first instance. Therefore, if the jury had awarded $256,000 in damages to plaintiffs based on their "overinsurance" theory, State Farm should have been entitled to judgment notwithstanding the verdict in any event.

Plaintiffs argued at trial that State Farm was acting in bad faith by permitting them to raise the policy limits on the property to $450,000 when the replacement cost or actual cash value of the property was less than that amount. Plaintiffs' expert, Garth Allen, testified that "overinsuring" was one aspect of his opinion that State Farm was in bad faith.

The first glaring logical problem with plaintiffs' overinsurance theory is that the property was already "overinsured" when plaintiffs bought it. The policy limits were $278,300 at the time plaintiffs requested assignment of the policy from the Pokresses. Therefore, according to plaintiffs' reasoning, State Farm acted in bad faith before there was even an insurer-insured relationship between the parties.

The policy limits were then raised at the request of Mitchell and Cotten based upon their representations to State Farm that the Bank told them they were underinsured.[1] The reason that the Bank was requiring plaintiffs to increase their policy limits was not because the value of the property was increasing, but because plaintiffs' *debt* was increasing. The reason that plaintiffs *debt* was increasing was that they were taking out construction loans for "funds to be advanced for construction of condominium at Mount Crested Butte, Colo."

Plaintiffs were not raising the limits of their policy based upon any assumption that the value of the property was increasing. They were raising the limits of their policy because their own bank required them to based upon their representation that the loan money was being utilized to improve the property. Presumably, if plaintiffs had used the construction loan money for its stated purpose of improving the condominium properties, the value of the property would have increased. In fact, Mr. Cotten testified that if the $385,000 plaintiffs took out in loans from the Bank had been used to improve the property, it would have been worth $755,000. (Resp. App., p.1) The promissory note executed by plaintiffs for the $385,000 loan from the Bank indicated the appraised completed value of the property would be $755,000. The appraisal report from Crested Butte Realty Company to the Bank appraised the property at $755,000 upon completion of the construction improvements. However, plaintiffs did not use the construction loan money to improve the property.

Mr. Cotten testified that when the fire occurred, plaintiffs had spent all of the loan money without improving the property. (Resp. App., p.2) Mr. Cotten also testified that if State Farm hadn't agreed to increase the insurance coverage, plaintiffs would have gone to another insurance company instead. (Resp. App., pp. 3-4) The fact that State Farm may have known the

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[1] Thus, indulging for a moment in the false assumption that plaintiffs' "overinsuring" theory had any merit, they sued the wrong party. If anyone owed them a duty under these circumstances, it would have been the Bank, not State Farm.

property was not worth $450,000 at the time plaintiffs executed these loans has no legal or logical relevance. Plaintiffs undisputedly knew this fact as well.

Plaintiffs borrowed $385,000 and represented to the Bank and State Farm that this money would be used to remodel the property State Farm insured for them. Because the Bank demanded that plaintiffs increase their policy limits and, based on their estimation of what the property would be worth after putting $385,000 into construction, State Farm complied with plaintiffs' request to increase the policy limits. Several years later, when the property burned and plaintiffs had not put one dime of that loan money into the property, the property was naturally worth much less than the policy limits. Plaintiffs then sued State Farm for bad faith and requested as "damages" that State Farm assume their debt to the Bank, or pay the difference between the policy limits and what State Farm actually owed under the policy. This theory of bad faith liability is incomprehensible under the facts of this case. The fact that Garth Allen predicated, in part, his conclusion that State Farm's conduct was in "bad faith" for "overinsuring" the property is immaterial. Testimony devoid of common sense is not transformed into legitimate evidence simply because its proponent is deemed an "expert." *See Viterbo v. Dow Chemical Co.,* 826 F.2d 420, 421 (5th Cir. 1987).

Plaintiffs' implication that State Farm's expert, Kent Miller, agreed with Mr. Allen's opinion is deliberately misleading. The excerpt of Mr. Miller's testimony contained in plaintiffs' petition for certiorari was directed to a theory of "overinsurance" in a vacuum, without reference to the circumstances of this case. What plaintiffs neglected to include in their appendix was Mr. Miller's testimony regarding plaintiffs' "overinsurance" theory with reference to the facts of *this* case:

> Q Mr. Miller, if the insured requests that the company increase the insurance coverage and the basis for the request is the bank is requiring that the amount of the insurance on that property be

increased to the amount of the loan, in your opinion, does the company act properly in increasing the coverage under those circumstances?

A Now I think — you're talking about *this* case?

Q Yes, sir.

A Yes. And the additional consideration is that the bank loans for construction or improvement of the property if the request to the insurance company is — the insured says, I want to increase the coverage on the property. I want to do that because the bank has requested it and the request is pursuant to a construction loan that we are taking out to improve the property, the expectation by the insurance company is that the property will increase substantially in value, something consistent with the money being put into the property. (Emphasis added)

(Resp. App., pp. 5-6)

Since plaintiffs' "overinsurance" theory of liability had no legal or logical basis under the facts of this case, the jury's verdict could not stand, even if it had been permitted, pursuant to the jury instructions, to award damages to plaintiffs under this theory of bad faith. Consequently, certiorari review is unnecessary for this reason as well.

C. Plaintiffs Waived Their Argument That State Farm Waived its Inconsistent Verdicts Argument Since Plaintiffs did not Advance This Argument Until Their Petition for Rehearing

An argument not raised in an appellate brief or at oral argument may not be raised for the first time in a petition for rehearing. *Costo v. United States,* 922 F.2d 302 (6th Cir. 1990); *United States v. Lewis,* 798 F.2d 1250 (9th Cir. 1986). Nor may a party shift its position on an issue in a petition for rehearing. *United States v. Smith,* 781 F.2d 184 (10th Cir. 1986).

Plaintiffs' argument in their answer brief and at oral argument with respect to the inconsistent verdicts issue was directed only at the merits of State Farm's position that the verdicts were inconsistent. Plaintiffs did not argue that State Farm waived its right to raise the issue by not objecting at trial. For this reason alone, plaintiffs' contention that State Farm waived the right to raise the inconsistent verdicts issue in its post-trial motions and on appeal must be rejected. *Costo v. United States, supra.*

While, under special circumstances, appellate courts have the discretion to address arguments raised for the first time in a petition for rehearing, *see Boardman v. Estelle,* 957 F.2d 1523 (9th Cir. 1992), it is within its discretion *not* to do so as well. *Boardman v. Estelle, supra.* Plaintiffs offered the Tenth Circuit no reason why it should address the "waiver" issue raised for the first time in its petition for rehearing, and, consequently, the Tenth Circuit clearly did not abuse its discretion in ignoring plaintiffs' argument. The only reason plaintiffs offer this Court as justification for raising this issue for the first time in their petition for rehearing is that they "did not deem the argument significant enough to devote appellate brief space to it . . ." in their answer brief in the Tenth Circuit. (Plaintiffs' petition for rehearing, p.22,n.6) This statement rivals plaintiffs' "overinsurance" theory of bad faith liability for pure gall. If plaintiffs did not perceive the argument significant enough to waste the Tenth Circuit's time, they certainly should not be wasting this Court's time with it.

Moreover, a party's failure to object to a verdict on the ground of inconsistency prior to the jury's discharge waives his right to raise the issue in a post-trial motion or on appeal *unless the verdict is inconsistent on its face so that entry of judgment on the verdict is plain error. Hinds v. General Motors Corp.,* 988 F.2d 1039, 1047 (10th Cir. 1993); *Diamond Shamrock Corp. v. Zinke & Trumbo Ltd.,* 791 F.2d 1416, 1424 (10th Cir. 1986). As the Tenth Circuit held, the jury verdicts were inconsistent on their face since the jury found that State Farm did not breach the contract, that State Farm did breach the duty of good faith and fair dealing, yet it awarded plaintiffs $256,000 in damages, which amount

could only have been awarded, if at all, pursuant to the breach of contract, and not the bad faith, claim. Consequently, the inconsistency does constitute plain error. *See Hinds v. General Motors Corp., supra.*

D. Assuming the Necessity of Further Proceedings, a Retrial of both Liability and Damages is Mandated

As articulated in State Farm's cross-petition for certiorari, filed contemporaneously with this brief in opposition, further proceedings are unnecessary since State Farm is entitled to judgment as a matter of law because plaintiffs did not prove any damages resulting from State Farm's conduct. However, assuming, *arguendo,* that further proceedings are necessary, the Court of Appeals order remanding for a determination of both liability and damages pursuant to plaintiffs' bad faith claim is appropriate. Where a jury's liability verdict is inconsistent with its damages verdict, a retrial on *both* liability and damages is necessitated. *Fugitt v. Jones,* 549 F.2d 1001, 1005 (5th Cir. 1977). Since such inconsistent verdicts demonstrate confusion on the part of the jury, retrial of both liability and damages is obviously necessary to resolve the inconsistency.

CONCLUSION

Since the Tenth Circuit correctly concluded that the jury's verdicts were irreconcilably inconsistent, and since plaintiffs' "overinsurance" theory of liability was baseless as a matter of law, plaintiffs' contention that their Seventh Amendment rights have been violated is without merit. There exists no reason for this Court to grant certiorari. Sup. Ct. R. 10.1.

Dated this 11th day of August, 1994.

Respectfully submitted,

ALAN EPSTEIN
OF HALL & EVANS, L.L.C.
1200 - 17th Street, Suite 1700
Denver, Colorado 80202
303/628-3300
ATTORNEYS FOR RESPONDENT

CERTIFICATE OF MAILING

I hereby certify that on this 11th day of August, 1994 a true and correct copy of the foregoing **OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT** was mailed by placing the same in the United States Mail, postage prepaid, addressed as follows:

Miles C. Cortez, Jr., Esq.
Marilyn S. Chappell, Esq.
Stephen J. Hensen, Esq.
McKenna & Cuneo
370 - 17th Street, Suite 4800
Denver, Colorado 80202

APPENDIX A

Excerpts of Trial Transcript 1a

APPENDIX

Q He gave you a letter to give to the bank that if you completed this construction, this property would be worth $755,000, right?

A Yes, sir.

Q And that was the market value that you used for purposes of obtaining this loan from the First National Bank, right?

A Yes, sir, it was. And there are variances in the values of the units because the upstairs units — the downstairs units were just — were two-bedroom with no loft. The upstairs units had humongous lofts up there. Gosh, you sleep 12, 16 people up in those lofts, so they had a higher value. Plus they had maybe a little better view, too, from up higher.

Q If you, in fact, had used the $385,000 for improvements on this property, would it have been worth $755,000 or close to that, in your opinion?

A Oh, I think it was close to that, in my opinion, without any remodel.

Q It would have been, certainly, after remodeling was completed, then; is that right?

A I certainly believe it would have perhaps been worth more than that. You know, it was a better location than where I had just purchased for $160,000.

Q Now, Mr. Mitchell handled all of the disbursements or advances on the loan; is that right?

A To the vast majority, yes, sir, he did. Again, I go back,

Q In fact, I thought I heard you testify that the bank would apply the interest to the loan itself rather than you paying it which would increase the loan.

A Sir, I believe I testified that we would take money — there were times that we did it in different ways; that sometimes the bank, yes, would — we would make a drawdown and pay some interest. There were some times when we would take a

partial draw and take money out of our pocket and pay the interest due that way. And then there were some times that we just took the money out of our pocket and made the interest payments, I believe was my testimony. If it wasn't, that's sure what it needs to be.

Q And as I understand it, by the time this fire occurred, you and Mr. Mitchell had spent all of the loan proceeds from that loan from First National Bank; is that correct?

A In looking at the note, yes, sir, it is correct.

Q You and Mr. Mitchell provided the bank with an appraisal letter from Mr. Jacobsen up in Crested Butte as to the value of this property before you obtained the loan from the bank; isn't that correct?

A No, sir, that's not correct. It was not an appraisal letter. That's been mischaracterized. It was just an estimate of value that if we added the fifth unit to them and did the work that we intended to do — Mr. Jacobsen is a realtor in the Mount Crested Butte area, and this is what these units — we

Q company rebuild that was a building that you and Mr. Mitchell owned?

A As I previously testified to, this was a company that I owned 50 percent of. You know, had this company gone up and rebuilt this building, then that would have been a contract that we could have not taken somewhere else that would have tied that company up, plus I had a partner in that company that I didn't feel it was prudent to tell him he had to do something at cost with no profit being involved in it.

Q Mr. Cotten, you testified earlier that these insurance increases were necessitated because the bank required them in connection with the loan that you had on the Mount Crested Butte property, right?

A Yes. I testified to that as well as we felt it an obligation that we had to all our lenders, you know, both the bank, the

Pokresses, you know, all the lenders involved in this thing. We had an obligation to them to keep the building covered.

Q And if, in fact, State Farm would not have increased the insurance coverage up to the amount of the loan that the bank had, you would have had to have gone to some other insurance company to obtain that insurance, right?

A That would have certainly given us the opportunity to go shopping around. Had State Farm ever told us that they did not want to increase the premium; if they ever told us that — as I understood in this court, that they had a replacement estimate of 155,000; had they ever told this to us —

Q Mr. Cotten, that's not responsive. Could you answer my question. Would you have gone to that source to obtain that insurance if State Farm would not have increased the coverage that the bank was requiring? That's my question.

A That's what I was trying to answer. Yes, sir, it would have given us that opportunity.

Q That's what you would have done?

A Yes, sir.

Q All right. You testified earlier today — I'll refer you to Exhibit — Defendant's — I'm sorry — Plaintiff's Exhibit 44. Would you refer to that, please. That's a letter from your attorney to State Farm, is it not — or to State Farm's attorney, Mary Wells?

A Well, this is a letter to Mr. Ehrsam, I believe.

Q You're right, it's a letter to Mr. Ehrsam from your attorney, Mr. Taylor. Is that right?

A Yes, sir, it is.

Q And would you refer to Plaintiff's Exhibit 47 and identify that, please.

A Yes. This is a letter from Philip Taylor to Stephen J. — I believe it's Baity. Is that the correct pronunciation?

Q Yes. And State Farm, in fact, responded to both of those letters, did they not, Mr. Cotten?

won't take your premium because we'll never pay that much. You are wasting your money to pay that kind of premium. And more important, we don't want you to think that if there's a fire, we're going to pay anything like that? An insurance company has a duty to tell their insureds that; isn't that true?

A Yes, if they know there's an attempt to overinsure the property.

MR. CORTEZ: I have no further questions. Thank you.

THE COURT: Anything else of this witness?

MR. HUNSAKER: Just one short question, Your Honor.

REDIRECT EXAMINATION

BY MR. HUNSAKER:

Q Mr. Miller, if the insured requests that the company increase the insurance coverage and the basis for the request is the bank is requiring that the amount of the insurance on that property be increased to the amount of the loan, in your opinion, does the company act properly in increasing the coverage under those circumstances?

A Now I think — you're talking about this case?

Q Yes, sir.

A Yes. And the additional consideration is that the bank loan is for construction or improvement of the property. If the request to the insurance company is — the insured says, I want to increase the coverage on the property. I want to do that because the bank has requested it and the request is pursuant to a construction loan that we are taking out to improve the property, the expectation by the insurance company is that the property will increase substantially in value,

something consistent with the money being put into the property.

So the insurance company, I think, acts reasonably — the insurance company can't say, We have to see the blueprints. We want an appraisal. How do we know it will be worth that much? I think the insurance company acts on the good faith understanding that the insured has made that the value of the property is going to go up, there's a big loan on the property, the bank requires its collateral be insured in this amount. And the insurance company will in all instances, I think, respond to that by saying, All right, we will raise the coverage.

Q And do you have an opinion as to whether the insurance company has any obligation to check to see if the proceeds of the construction loan are, in fact, being used for improvements on the property?

A I don't know of any insurance company that undertakes that kind of responsibility. They rely upon banks not to disburse construction loans until and unless the property is being improved. And banks have departments and people set up to handle disbursements of construction loans pro rata to the progress being made on the property. So the insurance company

(3)

Supreme Court, U.S.
FILED
SEP 12 1994
OFFICE OF THE CLERK

No. 94-56

IN THE
SUPREME COURT of the UNITED STATES
OCTOBER TERM, 1994

RICHARD MITCHELL AND LARRY COTTEN,
Petitioners,

v.

STATE FARM FIRE AND CASUALTY COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

PETITIONERS' REPLY MEMORANDUM

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STATEMENT OF THE CASE

Respondent's statement of the case ignores the evidence supporting Petitioners' claim. Accordingly, in keeping with the admonition of Supreme Court Rule 15.1, Petitioners briefly set forth the facts below.

On December 7, 1981, Petitioners Larry Cotten and Richard Mitchell purchased a four-unit condominium complex in Crested Butte, Colorado from the Pokress family. At the time Petitioners purchased the property, it was insured with the Respondent, State Farm Fire and Casualty Company. State Farm consented to an assignment of the policy from the Pokress family to Petitioners.

In May 1982, Mitchell and Cotten obtained a $385,000 line of credit loan from an Arkansas bank, to draw against as needed to pay operating expenses, interest payments and ultimately remodeling expenses on the property. The loan was secured by a deed of trust on the property. As required by the loan documents, State Farm added the bank to the policy as an additional insured and loss payee.

From May 1982 through April 1985, Petitioners drew down against the loan as moneys were needed for the property. Contrary to State Farm's insinuation of improper use of loan proceeds, there was never a dispute between the bank and Petitioners regarding the expenditure of the funds.

Despite State Farm's efforts to imply that Petitioners were responsible for overinsuring the property, the evidence showed that State Farm knowingly overinsured the property for amounts it would never pay. Whenever the loan balance exceeded the insurance coverage, the bank obligated Petitioners to obtain additional insurance coverage to protect the bank's security interest in the property. On each such occasion, Mitchell and Cotten called the State Farm agent, John O'Shea, and explained that they needed to increase the

insurance coverage on the property because the balance on the loan had increased and they needed to ensure that their lenders were fully protected. Each time Petitioners made such a request, State Farm increased the insurance coverage without disclosing that it would pay only replacement cost, not the increased face amount of the policy, in the event of a total loss. State Farm also never disclosed that it had obtained an appraisal placing the replacement cost for the property at only $158,723. Instead, State Farm continued to increase the insurance and collect the ever-increasing premiums. By May 1985, State Farm had increased the insurance on the property to $450,000, almost three times the replacement cost determined by Mr. O'Shea.

On May 26, 1985, the property was totally destroyed by an arson fire. Despite State Farm's continued efforts to imply that Mitchell and Cotten were responsible for the fire, no evidence was adduced that Mitchell or Cotten had anything to do with the fire and State Farm has admitted that it cannot establish that Petitioners committed arson. In fact, State Farm never raised an arson defense.

Petitioners have never disputed that State Farm was entitled to reasonably investigate their claim to determine whether the insured caused the loss. However, State Farm crossed the line of reason and breached its duty of good faith. Shortly after the fire, State Farm began an investigation to establish an arson defense. State Farm hired a lawyer to aid it in "direction toward an investigation leading to possible litigation." State Farm also assigned two adjusters to determine whether Petitioners caused the fire.

One of State Farm's adjusters questioned Petitioners at length and Petitioners fully answered every question. State Farm learned and reconfirmed that Petitioners were in Arkansas, not in Colorado, at the time of the fire. State Farm

concluded that Petitioners were experiencing financial difficulties with respect to the property at the time of the fire, but were otherwise financially solvent.

As the result of its thorough investigation, by September 1985, State Farm knew or should have known that it could not prove the arson defense. Nonetheless, rather than paying the claim, State Farm continued its misdirected efforts to prove that Petitioners caused the fire. State Farm's attorney again interrogated Petitioners for several hours on two separate occasions, and the evidence at trial established that State Farm otherwise engaged in conduct designed to harass and intimidate its insureds. State Farm's attorney finally advised State Farm that the evidence was insufficient to deny Petitioners' claim and recommended that State Farm settle the claim. Despite this advice from its attorney, State Farm still did not pay the claim.

After enduring 14 months of State Farm's unreasonable conduct and refusal to pay benefits, Mitchell and Cotten filed suit on July 10, 1986. On April 30, 1992, nearly six years later, the jury concluded from its review of all the evidence presented that State Farm breached its duty of good faith and fair dealing. The jury found the compensatory damages resulting from the tort to be $256,000. Since the jury also found *beyond a reasonable doubt* that State Farm's tortious conduct was "attended by circumstances of insult or a wanton and reckless disregard of the rights or feelings" of Petitioners, it was permitted to award exemplary damages of $10,000. The jury found in favor of State Farm on Petitioners' claim of breach of contract.

State Farm appealed to the Tenth Circuit Court of Appeals. A panel of the Tenth Circuit vacated the judgment and remanded Petitioners' claim of breach of the duty of good faith and fair dealing to the trial court. The panel

vacated the judgment because it found the jury verdicts inconsistent. Contrary to Respondent's statement of the Tenth Circuit's holding, the court did not find the verdicts inconsistent on the basis that no evidence of $256,000 in damages was introduced. Also contrary to Respondent's representation, the Tenth Circuit never ruled that the verdicts were inconsistent on their face. Rather, the court found the verdicts inconsistent because the jury determined that State Farm did not owe Mitchell and Cotten $450,000 under the contract, but must have measured Petitioners' damages for the breach of duty claim by the difference between $450,000 and the amount State Farm paid to Petitioners' mortgagees.

Mitchell and Cotten submitted a Petition for Rehearing and Suggestion for Rehearing In Banc to the Tenth Circuit. A panel of the Tenth Circuit denied the Petition. Once again, Respondent misstates the Tenth Circuit's holding. Contrary to State Farm's assertions, the court did not find that the jury verdicts were inconsistent because Petitioners did not introduce evidence of $256,000 in damages. Instead, the court determined that the jury was instructed that Petitioners' claim of breach of the duty of good faith and fair dealing was based on unreasonable delay and that delayed payment was not synonymous with overinsurance or misleading conduct.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

A. The Jury Verdicts Can Be Fairly Harmonized Within the Jury's Instructions and the Tenth Circuit's Failure to Reconcile the Verdicts Violates the Seventh Amendment.

In the Opposition to the Petition for Writ of Certiorari, Respondent contends that the jury instructions precluded the

jury from considering the overinsurance aspect of the case in finding that State Farm breached its duty of good faith and fair dealing. Respondent repeats the precise error of the Tenth Circuit by construing the instructions as narrowly as possible in its "search for one possible view of the case that will make the jury's findings inconsistent." *Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines, Ltd.*, 369 U.S. 355, 364 (1962). That analysis is directly contrary to the duty of an appellate court under the Seventh Amendment "to attempt to harmonize [the jury's] answers, if it is possible under a fair reading of them." *Gallick v. Baltimore & Ohio Railroad Co.*, 372 U.S. 108, 119 (1963).

Respondent claims (and the Tenth Circuit ruled) that the jury verdict in this case cannot be reconciled because the jury could not have found both that there was no breach of contract and that there was a tortious breach of duty resulting in compensatory damages of $256,000. However, the verdicts can be fairly harmonized and should have been harmonized by the Tenth Circuit. Under Colorado law, the tort claim of breach of an insurer's duty of good faith and fair dealing is separate and distinct from a claim of breach of contract. *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1271-74 (Colo. 1985) (en banc); *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1140-42 (Colo. 1984). The insurer's tort liability does not depend upon its liability under the insurance contract. *Flickinger v. Ninth Dist. Prod. Credit Ass'n*, 824 P.2d 19, 24 (Colo. App. 1991), *cert. denied* (Colo., Jan. 27, 1992). Thus, an insurer can act tortiously and breach its duty of good faith and fair dealing, even if the insurer has not breached the contractual provisions of an insurance policy.

The jury so found here. Respondent acknowledges that the issue of overinsurance was submitted to the jury. (Opp. Br. at 8.) The jury heard evidence that Mitchell and Cotten

contacted State Farm's agent, Mr. O'Shea, and informed him that they needed additional insurance to cover their liability to the bank. (Pet. App. I at 2i-3i.) Mr. O'Shea repeatedly sold them that additional coverage, eventually increasing policy limits to $450,000, despite his undisclosed possession of an appraisal placing the replacement value of the property at only $158,723. (Pet. App. I at 4i-6i.) State Farm presented no evidence that Mr. O'Shea ever informed Petitioners that in the event of a total loss State Farm would only pay replacement value. (Pet. App. I at 13i-14i.) Had he done so, Petitioners would have had the opportunity to look elsewhere for additional insurance to cover the amount of their liability to the bank. Petitioners' counsel pointed out in closing argument that State Farm was aware of the overinsurance problem within three months after the fire, but nonetheless refused to pay the promised coverage. (Pet. App. I at 11i.)

The jury instructions, when considered in light of the evidence submitted to the jury, encompassed the overinsurance aspect of State Farm's tortious conduct. The instruction on the claim of breach of the duty of good faith and fair dealing contained as an element that the insurer "acted unreasonably in delaying payment on plaintiffs' claim without a legitimate basis for said delay." (Pet. App. J at 3j.) Petitioners had made a claim for $450,000, the amount of coverage that Mr. O'Shea had led them to believe they had. The jury must have found that, in light of State Farm's knowledge of the overinsurance problem, it had no legitimate basis for delaying payment of Petitioners' claim for the coverage as represented.

The jury must have found further that the measure of the damage caused to Petitioners by State Farm's wrongful conduct was the difference between the promised amount of coverage (which, as of May 1985, would have covered

petitioners' bank debt) and the amount that State Farm had paid to Petitioners' mortgagees. It is obvious from questions asked during jury deliberations that the Petitioners' obligation to the bank was significant to the jury. (Reply App. A.) It is not inconsistent for the jury to find that the policy language limited State Farm's contractual liability to replacement value, but that State Farm acted tortiously by (among many other wrongful actions during the claims-handling period) unreasonably delaying payment of the amount of protection that Mr. O'Shea led Petitioners to believe the policy afforded them.

Petitioners were forced to wait over seven years after the fire before finally presenting their case to a jury. The jury listened to the evidence, saw the witnesses, and not only concluded that State Farm breached its duty of good faith and fair dealing, but also found *beyond a reasonable doubt* that such failure was "attended by circumstances of insult or a wanton and reckless disregard of the rights and feelings" of Petitioners, thereby warranting an award of exemplary damages. (Reply App. B; Pet. App. C at 3c.) The jury's conclusions should not be disregarded lightly. The District Court found no irreconcilable inconsistency in the jury's verdicts. The Court should grant certiorari to review whether the Tenth Circuit acted contrary to the Seventh Amendment and denied Petitioners their right to trial by jury in reversing that verdict.

B. Respondent's Attempt to Retry the Overinsurance Issue Is Not Appropriate in the Supreme Court.

Without citing any law whatsoever, Respondent argues that certiorari review is unnecessary in this case because Petitioners' overinsurance theory is without merit as a matter of law. (Opp. Br. at 8.) Contrary to State Farm's

characterization, its argument is not a matter of law at all. Rather, Respondent argues that the theory does not apply to the facts of this case. Essentially, State Farm is asking the Court to retry factual issues already established by the jury verdict. Neither the Supreme Court nor the courts of appeals can redetermine facts found by the jury. *Atlantic & Gulf Stevedores, Inc.*, 369 U.S. at 358-59.

The jury heard all of the evidence and determined that Respondent breached its duty of good faith and fair dealing. Among the testimony presented to the jury on the overinsurance theory was that of Professor Garth Allen. Professor Allen testified that insurance industry practices and procedures require an insurer to advise an insured when the insurer knows it will pay substantially less than policy limits in the event of a total loss. Professor Allen did not testify that overvaluation alone constituted unreasonable conduct. Instead, he explained that overvaluation, coupled with the other evidence he reviewed, led him to conclude that State Farm's conduct was unreasonable. State Farm's own expert, J. Kent Miller, acknowledged that an insurance company has a duty to advise an insured that it is overinsuring its property. State Farm did not discharge that duty to Petitioners here.

Based on the testimony, the jury concluded that Respondent breached its duty to Petitioners. The Supreme Court should not now redetermine the facts to conclude that the overinsurance theory was not applicable to this situation.

C. The Respondent's Failure to Raise the Alleged Inconsistency in the Verdicts While the Jury was Empaneled Cannot Be Cured By Claiming Waiver.

As Respondent acknowledges, "a party's failure to object to a verdict on the ground of inconsistency prior to the jury's

discharge waives his right to raise the issue in a post-trial motion or on appeal, unless the verdict is inconsistent on its face so that entry of judgment on the verdict is plain error." (Opp. Br. at 12.) Contrary to Respondent's representation to the Court, the Tenth Circuit never found the verdicts in this case to be "inconsistent on their face." *Id.* Instead, it was only by analyzing evidence of damages and the means whereby the jury derived the figure of $256,000 that the Tenth Circuit determined (erroneously) that the verdicts were inconsistent. Without that analysis of the underlying evidence, there is not even a potential inconsistency in the verdicts. A verdict finding against a plaintiff on a breach of contract claim but for the same plaintiff on a tort claim is not facially inconsistent, where, as here, the claims are submitted to the jury for separate, distinct consideration. *Diamond Shamrock Corp. v. Zinke & Trumbo, Ltd.*, 791 F.2d 1416, 1425 (10th Cir.), *cert. denied*, 479 U.S. 1007 (1986); *accord Resolution Trust Corp. v. Stone*, 998 F.2d 1534, 1547 (10th Cir. 1993).

Respondent seeks to overcome its failure to timely raise the purported inconsistency in the verdicts by pointing to the fact that Petitioners did not raise their waiver argument until the petition for rehearing on appeal was filed. That claim cannot survive either logical or practical scrutiny. Once Respondent allowed the jury to be discharged without objecting to the verdicts on the basis of inconsistency, its right to assert that argument in the future expired. As a matter of logic, Petitioners' failure to call the courts' attention to the waiver cannot revive Respondents extinguished argument.

Furthermore, the reason for the rule requiring that objections on the basis of inconsistency in verdicts be raised while a jury is empaneled is to give the trial court the opportunity to determine the best means of correcting the

inconsistency, including ordering the jury to deliberate further. *Diamond Shamrock Corp.*, 791 F.2d at 1422-23. Unless there is a facial inconsistency in the verdicts, the trial court cannot be expected to notice, in the absence of an objection, that there is a potential inconsistency in the verdicts. *Resolution Trust Corp.*, 998 F.2d at 1574. There is no similar consideration of trial efficiency that would be served by a ruling that Petitioners' failure to immediately raise the waiver argument revived the Respondent's inconsistency claim. Even if Petitioners had raised the waiver issue in response to Respondent's post-trial motion, Respondent could not have cured its failure to raise the alleged inconsistency while the jury was empaneled.

CONCLUSION

For the reasons stated herein, and as set forth in the Petition for a Writ of Certiorari, Petitioners respectfully request that this Court issue a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit.

Respectfully submitted,

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APPENDIX

APPENDICES

Appendix A:

Portions of Transcript from Trial Proceedings..... 1a

Appendix B:

Portion of Jury Instructions..... 1b

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

RICHARD MITCHELL AND LARRY COTTEN,	)	
Plaintiffs-Appellees,	)	No. 92-1208
	)	D.C. No. 86-S-2171
v.	)	
	)	APPELLANT'S APPENDIX
STATE FARM FIRE AND CASUALTY COMPANY,	)	REPORTER'S TRANSCRIPT
Defendant-Appellant.	)	

Appeal from the United States District Court
District of Colorado
The Honorable Daniel B. Sparr

Alan Epstein of HALL & EVANS (William J. Hunsaker of MAKRIS, HUNSAKER, TOWEY & MELONAKIS, P.A., with him on the brief), Denver, Colorado, for Defendant-Appellant.

(The jury left the courtroom at 2:34 p.m.)

[BY THE COURT] All right, Counsel. Remain available. We'll be in recess in this matter.

(Recess at 2:35 until 3:45 p.m. The following proceedings were held in chambers out of the presence of the jury. Mr. Cortez and Mr. Hunsaker were not present.)

[THE COURT] The question is, Is the bank owed any moneys on the loan by Cotten and Mitchell at this time? And if so, what is the dollar amount?

I don't have any intention of answering the question.

[MR. KEILLY] I would agree with that, Your Honor.

[MR. HENSEN] It's reflected on one of the exhibits if they had any questions about it. They can find it for themselves.

[THE COURT] The answer to the question would be that you are to determine the issues of the case based on the evidence. Is that agreeable with everybody?

[MR. HENSEN] That's fine.

[THE COURT] Here it is as it will be returned to the jury. Any other suggestions or objections to the answer?

[MR. HENSEN] None, Your Honor.

[MR. KEILLY] No.

[THE COURT] Very well.

(Recess at 3:47 until 4:45 p.m. The following proceedings were held in chambers out of the presence of the jury. Mr. Cortez and Mr. Hunsaker were not present.)

[THE COURT] All he did was write on the bottom of the old question, Where is the answer?

[MR. HENSEN] Do we just tell them the answer is in the evidence and it's for you to determine that?

[THE COURT] We'll see. Is the bank owed any moneys on the loan by Cotten and Mitchell at this time? And if so, what is the dollar amount? The answer was, You are to determine the issues in the case based on the evidence. And the question came back again, Where is the answer?

* * *

[THE COURT] That's fine. The answer to your question, if any, must be determined by your consideration of the evidence presented by testimony and exhibits -- by testimony, exhibits --

[MR. HENSEN] Or otherwise?

[THE COURT] -- stipulations, or other evidence as defined in the instructions. I cannot comment upon the evidence or find facts as that is the jury's exclusive province. You must rely upon your best recollection of the evidence to answer this inquiry. Is that all right?

[MR. HENSEN] That's acceptable on behalf of the plaintiffs, Your Honor.

[MR. KEILLY] I believe that's acceptable, Your Honor.

[THE COURT] Now, I will cross this out on the previous question and indicate that this is not -- was not presented to the jury. I will not give this question back to them.

[MR. KEILLY] That's fine, Your Honor.

[THE COURT] All right. Take it back.

(Appellant's Appendix Reporter's Tr., Vol. VIII, p. 1094, l. 12-p. 1095, l. 21; p. 1099, ll. 1-18, Trial Proceedings, April 29, 1992.)

INSTRUCTION NO. 31

If you find in favor of the Plaintiffs, and award them actual damages for their claim of Breach of Duty of Good Faith and Fair Dealing, then you shall consider whether exemplary damages should be assessed against the Defendant. If you find beyond a reasonable doubt that the injury complained of was attended by circumstances of insult or a wanton and reckless disregard of the rights and feelings of the Plaintiffs, then in addition to actual damages, you may also assess a reasonable sum as exemplary damages.

Exemplary damages, if assessed, are to be assessed as punishment of the Defendant, and as an example to others.